Petition and Transcript of Record

Supreme Court of the United States

OCTOBER TERM, 1930

No. 124

THE FIRST NATIONAL BANK OF CHICAGO, A NATIONAL BANKING ASSOCIATION, PETITIONER,

vs.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED MAY 16, 1930

CERTIORARI GRANTED JUNE 2, 1930

(35,036)

(35,036)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929

No. 905

THE FIRST NATIONAL BANK OF CHICAGO, A NATIONAL BANKING ASSOCIATION, PETITIONER,

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THE UNITED STATES

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., MAY 17, 1930

[fol. 1]

IN SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1929

No. 905

THE FIRST NATIONAL BANK OF CHICAGO, a National Banking Association,

vs.

THE UNITED STATES

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner respectfully shows as follows:

On February 28, 1928, it presented its petition to the Court of Claims, praying a judgment against the United States in the amount of $9,124.70, representing, as alleged, the amount of Federal income tax illegally assessed and collected by the United States from the plaintiff for the year 1922, with interest thereon. Claim for refund of such tax so assessed and collected from the petitioner had been disallowed by the Commissioner of Internal Revenue.

The First National Bank of Chicago, as set forth in said petition, in its consolidated 1922 income tax return included the returns, among others, of the First-Trust Joint Stock Land Bank of Chicago and the First-Trust Joint Stock Land Bank of Dallas, organized, respectively, under the Federal Farm Loan Act of July 17, 1916. In said latter returns interest in the amount of $78,807.80, paid by said Joint Stock Land Banks, respectively, on their bonds issued and outstanding in the hands of the public, was deducted as [fol. 2] "interest paid or accrued within the taxable year on its indebtedness" under Section 234 (a) (2) of Title II of the Revenue Act of 1921. Said deduction was disallowed by the Commissioner of Internal Revenue on the ground that said interest fell within the exception clause of said Section 234 (a) (2) which reads in full as follows:

"Sec. 234. (a) That in computing the net income of a corporation subject to the tax imposed by Section 230 there shall be allowed as deductions:

(2) All interest paid or accrued within the taxable year on its indebtdeness,

except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title."

Question Presented

The single question at issue is whether interest paid by a Joint Stock Land Bank on its Joint Stock Land Bank bonds, issued to create a fund to make, and out of which are made, loans to farmers, in contemplation of the Federal Farm Loan Act, on the security of qualified first mortgages as defined in said Federal Farm Loan Act, is deductible from income under Section 234 (a) (2) of Title II of the Revenue Act of 1921, quoted above.

The case was heard on a stipulation of facts which was adopted by the Court of Claims as its special findings of fact.

This question, in one aspect, involves the interpretation of

(1) the purpose, scope and language of the exception clause of Section 234 (a) (2) of Title II of the Revenue Act of 1921.

[fol. 3] (2) the purpose of Congress in passing the Federal Farm Loan Act of July 17, 1916, and the relation thereof to the exception clause of said Section 234 (a) (2); and

(3) the scope and language of the "interest exemption section",—Section 213 (b) (4) (b) (particularly sub-section (b) thereof) of Title II of the Revenue Act of 1921, which reads as follows:

"Section 213. That for the purpose of this title (except as otherwise provided in Section 233) the term 'gross income', (b) does not include the following items, which shall be exempt from taxation under this title: (4) Interest upon

(a) the obligation of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916; or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income, war profits and excess profits taxes."

and, in its other aspect, involves the constitutionality of the exception clause in respect of interest deduction.

Reasons for Allowing this Petition

1. This is a "class" case and presents precisely a single question of law, the decision, of which will control several pending suits and many claims and questions of tax liability involving numerous taxpayers. These claims are recurrent in each year in respect of each of such taxpayers inasmuch as the law of 1921 controlling this question has [fol. 4] remained unchanged. An authoritative determination of this question will automatically decide pending cases, claims and questions of tax liability of these several taxpayers over a period of ten years, approximately, involving relatively large amounts of taxes.

2. The Court of Claims erroneously construed farmers' mortgage notes to be "securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916" as such phrase is used in Section 213 (b) (4) (b) of the Income Tax Law of 1921.

3. The Court of Claims erroneously ignored the question of the constitutionality of the exception clause of said Section 234 (a) (2).

4. Said exception clause has been declared unconstitutional by a Circuit Court of Appeals, in a case now before this Court, under circumstances which, on the application of principles laid down by this Court, would defeat the application of said exception clause to said indebtedness of Joint Stock Land banks.

Wherefore your petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this Honorable Court, directed to the Court of Claims of the United States, commanding that Court to certify and send to this Court for its review and determination, on a day certain to be herein named, a full and complete tran-[fol. 5] script of the record and all proceedings in the case numbered and entitled on its docket as J-71, The First National Bank of Chicago vs. United States; and that the said judgment of the Court of Claims may be reversed by this Honorable Court; and that your petitioner may have such other and further relief in the premises as to this Court may seem meet and just; and your petitioner will ever pray.

The First National Bank of Chicago by Harold V. Amboy, Attorney.

[fol. 1] IN THE COURT OF CLAIMS OF THE UNITED STATES

No. J-71

THE FIRST NATIONAL BANK OF CHICAGO, a National Banking Association,

against

THE UNITED STATES OF AMERICA

I. PETITION—Filed February 28, 1928

To the Court of Claims of the United States of America and to the Honorable Judges thereof:

The above named claimant, by this, its petition, respectfully shows:

1. The claimant at all times hereinafter mentioned was and is a national banking association organized and exist-

ing under the laws of the United States of America, engaged in the business of banking, and having its principal office at 38 South Dearborn Street, City of Chicago, County of Cook, State of Illinois.

2. The claimant has a just claim for the refund of $9,124.70 in respect of income tax illegally assessed and collected by the Commissioner of Internal Revenue of the United States of America for the period ending December 31, 1922, with interest thereon.

The provision of law under which the claimant claims such refund is Section 234 (a) (2) of the Federal Income Tax Law of 1921, being Title II of The Revenue Act of 1921.

[fol. 2] 3. Pursuant to Sections 239 and 240 of the Federal Income Tax Law of 1921 and the regulations thereunder, the claimant, as parent corporation and taxpayer, made to the Commissioner of Internal Revenue on March 14, 1923 a consolidated return, on official form number 1120, for the year ending December 31, 1922. Included in said consolidated return of the claimant, in addition to itself as parent corporation, were the claimant's affiliated corporations, as follows:

First Trust and Savings Bank, an Illinois corporation, Chicago, Illinois,

First National Investment Company, now First-Chicago Corporation, an Illinois corporation, Chicago, Illinois,

National Safe Deposit Company, an Illinois corporation, Chicago, Illinois,

First Trust Joint Stock Land Bank of Chicago, a joint stock land bank organized under the Federal Farm Loan Act of 1916, with its principal office in the City of Chicago, State of Illinois, and

First Trust Joint Stock Land Bank of Dallas, a joint stock land bank organized under the Federal Farm Loan Act of 1916, with its principal office in the City of Dallas, State of Texas.

4. In said consolidated return of the claimant it reported net income subject to the tax imposed by Section 230 of the Federal Income Tax Law of 1921 for the year 1922 of $3,482,004.88.

In computing said net income the claimant in said return deducted, in contemplation of Section 234 (a) (2) of Title II of The Revenue Act of 1921, in respect of interest paid during said period by the First Trust Joint Stock Land Bank of Chicago and the First Trust Joint Stock Land Bank of Dallas on their outstanding joint stock land bank bonds the aggregate amount for the year 1922 of $78,807.80. Said deduction, as hereinafter more fully set forth, has been disallowed by the Commissioner of Internal Revenue.

[fol. 3] 5. In respect of the Federal income tax based on said original consolidated return the claimant paid (with interest on the deferred payment) to the Collector of Internal Revenue, Chicago, Illinois, on the dates stated below, the following amounts:

March 14, 1923	$108,812.65
June 12, 1923	108,812 66
September 15, 1923	108,812 65
November 13, 1923	104,281 51
June 3, 1926	4,531 14
or a total of	$435,250 61

6. Subsequent to the filing of said original consolidated return the claimant filed with the Commissioner of Internal Revenue certain claims for credit in respect of the period ending December 31, 1922. Acting on the original return and these claims, and recomputing the assessment, but still disallowing said interest deduction, the Commissioner of Internal Revenue, by letter to the claimant dated October 29, 1927, ultimately fixed the taxable net income of the claimant for the year 1922 at $3,446,272.60 and determined the tax due thereon to be $430,784.08, and disclosed, exclusive of the over-assessment by virtue of the disallowance of said interest deduction, an over-assessment of taxes against the claimant for the year 1922 of $4,466.53.

The Collector of Internal Revenue, Chicago, Illinois subsequently refunded said last mentioned amount with interest to your claimant.

7. As set forth above, the claimant in reporting its net income subject to the tax imposed by Section 230 of the

Federal Income Tax Law of 1921, in its original return for the year 1922, deducted interest paid by the First Trust Joint Stock Land Bank of Chicago and the First Trust Joint Stock Land Bank of Dallas on their outstanding joint stock land bank bonds, respectively, amounting to $78,807.80. This deduction was disallowed by the field agent [fol. 4] of the Internal Revenue Department who examined said return of the claimant, and the claimant was notified of such disallowance by letter dated June 10, 1926, from the office of the Supervising Internal Revenue Agent, Chicago Division. The claimant protested such disallowance. The disallowance of said deduction was, over the protest of the claimant, adopted and followed by the Commissioner of Internal Revenue in his so-called 30-day letter dated August 2, 1926, in his so-called 60-day letter dated August 22, 1927, and in his final letter dated October 29, 1927.

In his determination of the taxable income for said period, however, the Commissioner of Internal Revenue allowed as a deduction, in respect of certain inter-company transactions in connection with interest on said joint stock land bank bonds for the year 1922 the amount of $5,810.25 which item the claimant concedes is not deductible in the event the interest paid by said Joint Stock Land Banks on their outstanding joint stock land bank bonds is a deductible item.

The Commissioner of Internal Revenue has illegally denied the claimant a net deduction in respect of its taxable income for said period the amount of $72,997.55 on which amount the Commissioner of Internal Revenue has illegally assessed and collected Federal income tax from the claimant for the year 1922 of $9,124.70.

8. On November 8, 1927, the claimant filed with the Collector of Internal Revenue of Chicago, Illinois, claim for refund of taxes illegally collected for the year 1922 in the sum of $9,124.70. A copy of said claim for refund is attached hereto, marked Exhibit "A" and made a part hereof. Said claim for refund was denied by the Commissioner of Internal Revenue by letter dated February 14, 1928, for the reasons, as set forth in said letter, as follows:

[fol. 5] "It is held that farmers' first mortgage notes executed to joint stock land banks are issued under the pro-

visions of the Farm Loan Act of 1916, that they are securities in the contemplation of Section 213 (B)(4)(B) of the Revenue Act of 1921; that they are acquired by purchase, and that the interest on bonds issued to furnish proceeds for their purchase is interest on an indebtedness incurred to purchase or carry obligations or securities the interest upon which is wholly exempt from taxation under Title II of the Revenue Act of 1921; and as such is not deductible as an expense."

9. No other action than as aforesaid has been had on this claim in Congress or by any of the Departments. The claimant has at all times borne true allegiance to the Government of the United States. It has not, in any way, voluntarily aided, abetted, or given encouragement to rebellion against such Government. It is and always has been the sole and absolute owner of the claim here presented. It has made no transfer or assignment of said claim or of any part thereof or of any interest therein. It is justly entitled to the amount claimed from the United States of America after allowing all just credits and set-offs.

10. The claimant believes the facts as hereinabove stated to be true.

Wherefore, the claimant prays judgment against the United States of America upon the facts and law for $9,124.70 with lawful interest thereon since the date of payment thereof and its reasonable costs and disbursements herein.

The First National Bank of Chicago, Claimant, M. A. Traylor, President. Harold V. Amberg, Attorney for Claimant.

[fol. 6] *Duly sworn to by Melvin A. Traylor. Jurat omitted in printing.*

[fol. 7] EXHIBIT "A" TO PETITION

Treasury Department, Internal Revenue Service,
Comptroller General U. S.

January 18, 1922.

Important.—Not acceptable unless completely filled in.

Claim for Refund of Taxes Illegally Collected

STATE OF ILLINOIS,
County of Cook, ss:

The First National Bank of Chicago and Affiliated Corporations, 38 South Dearborn Street, Chicago, Illinois.

This deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below with reference to said statement are true and complete:

	Period	Year
From	Jan. 1	1922
To	Dec. 31	1922

1. Business in which engaged: Banking.
2. Character of assessment or tax: Income Tax.
3. Amount of assessment or stamps purchased: $435,250.61.
6. Amount to be refunded (or such greater amount as is legally refundable): $9,124.70.

Deponent verily believes that this application should be allowed for the following reasons:

Deduction of interest paid by the First Trust Joint Stock Land Bank, Chicago, Ill., and the First Trust Joint Stock Land Bank, Dallas, Texas, on their own bonds, respectively, as per statement attached, was disallowed. This interest is deductible interest under section 234 (a)(2) of Title II of the Revenue Act of 1921, inasmuch as it does not fall within the exception in respect of interest "on indebtedness incurred or continued to purchase or carry ob-
[fol. 8] ligations or securities * * * the interest on which is wholly exempt from taxation under this title."

The interest does not fall within the excepted class of section 234(a)(2) in that, among other reasons, the interest on first mortgage farm loans is not "exempt from taxation

under this title" (Title II of the Revenue Act of 1921) because its exemption is derived solely from section 26 of the Federal Farm Loan Act. The interest exemptions of section 213(b)(4) of Title II of the Revenue Act of 1921 supplies no exemption inasmuch as the farmers' first mortgage notes are not securities "issued under the provisions of the Federal Farm Loan Act of July 17, 1926." The interest paid by these Banks on their bonds is, therefore, deductible interest.

(Signed) John P. Oleson, Vice President.

Sworn to and subscribed before me this 8th day of November, 1927. Edgar J. Harris, Jr., Notary Public. My commission expires July 23, 1931.

(Exhibit A continued next page)

[fol. 9] (Exhibit A Continued)

U. S. Income and Excess Profits Tax

Claim for Refund, Year 1922

Net Income Revised:

Income as assessed in adjustment of 60-day letter		$3,446,272.60
Corrected Income		3,373,275.05
Deduction (A)		72,997.55

(A) Net Interest paid on First Trust Joint Stock Land Bank bonds disallowed as a deduction

Explanation of Items changed

Interest paid on bonds:		
First Trust Joint Stock Land Bank, Chicago	$70,474.47	
First Trust Joint Stock Land Bank, Dallas	8,333.33	
	78,807.80	
Less Interest received on First Trust Joint Stock Land Bank Bonds as inter-company transaction: First Trust and Savings Bank	5,810.25	
		72,997.55

Computation of Tax

Corrected Net Income		$3,373,275.05
Tax at 12½%		421,659.38
Taxes Paid:		
Mar. 14, 1923	$108,812.65	
June 12, 1923	108,812.66	
Sept. 15, 1923	108,812.65	
Dec.-15, 1923 Credit A/C former years	108,812.65	
Oct. 29, 1927—Refund allowed in settlement of 60-day letter claim as per conference September 19, 1927	4,466.52	
		430,784.08
Refund Claimed		9,124.70

[fol. 10] II. General Traverse—Filed April 7, 1928

And now comes the Attorney General, on behalf of the United States, and answering the petition of the claimant herein, denies each and every allegation therein contained; and asks judgment that the petition be dismissed.

Herman J. Galloway, Assistant Attorney General.

D. E. R.

III. History of Proceedings

On March 19, 1929, this case was argued and submitted on merits by Mr. Harold V. Amberg, for plaintiff, and by Mr. Henry A. Cox, for defendant.

On May 6, 1929, the court filed findings of fact and conclusion of law, and entered judgment for plaintiff in the sum of $9,124.70, with interest, with an opinion by Moss, J., and dissenting opinion by Green, J.

On June 28, 1929, the defendant filed a motion for a new trial.

On December 2, 1929, the court entered the following order on said motion:

Order

It is ordered this 2d day of December, 1929, that the defendant's motion for new trial be and the same is allowed. The findings of fact, judgment and opinion filed herein May 6, 1929, are vacated, set aside and withdrawn and the case placed on the Trial Calendar.

By the Court.

IV. Argument and Submission on New Trial

On January 14, 1930, this case was argued and submitted on new trial by Mr. Harold V. Amberg, for plaintiff, and Mr. Henry A. Cox, for defendant.

[fol. 11] V. **Special Findings of Fact, Conclusion of Law, and Opinion of the Court by Williams, J.**—Filed March 3, 1930

Mr. Harold V. Amberg for plaintiff. Messrs. Robert N. Miller, J. Robert Sherrod, and John E. McClure, by leave of the Court, filed a brief as amici curiæ.

Mr. H. A. Cox, with whom was Mr. Assistant Attorney General Herman J. Galloway, for the defendant. Mr. C. M. Charest and Mr. Dwight E. Rorer were on the brief.

The only question involved in this suit is whether interest paid by a joint-stock land bank on its joint-stock land bank bonds, the proceeds of which are used to make loans to farmers, under the provisions of the Federal farm loan act of July 17, 1916, on the security of approved first mortgages as defined in said act, is deductible in computing the taxable income of such joint-stock land bank under section 234 (a) (2) of Title II of the revenue act of 1921.

This case having been heard by the Court of Claims, upon a stipulation of facts, signed on behalf of plaintiff by its attorney, Harold V. Amberg, and on behalf of the defendant by Assistant Attorney General Herman J. Galloway, and the evidence, the court makes the following

Special Findings of Fact

1. At all times herein mentioned, the plaintiff, the First National Bank of Chicago, was and now is a national banking association organized and existing under and by virtue of the laws of the United States of America, engaged in the business of banking, and having its principal office at 38 South Dearborn Street, city of Chicago, county of Cook, State of Illinois.

2. On or about March 14, 1923, plaintiff filed with the collector of internal revenue for the first district of Illinois a tentative consolidated corporation income and profits tax return for the calendar year 1922, said return disclosing an estimated consolidated net income of $3,482,004.88 and an estimated income and profits tax liability of $435,250.61. On or about June 13, 1923, plaintiff filed a completed consolidated corporation income and profits tax return for the [fol. 12] calendar year 1922, said return consolidating the income of the plaintiff corporation and the following affiliated corporations:

First Trust and Savings Bank, an Illinois corporation, Chicago, Illinois.

First National Investment Company, now First-Chicago Corporation, an Illinois corporation, Chicago, Illinois.

National Safe Deposit Company, an Illinois corporation, Chicago, Illinois.

First Trust Joint Stock Land Bank of Chicago, a joint-stock land bank organized under the Federal farm loan act of 1916, with its principal office in the city of Chicago, Illinois.

First Trust Joint Stock Land Bank of Dallas, a joint-stock land bank organized under the Federal farm loan act of 1916, with its principal office in the city of Dallas, Texas.

Such consolidated return disclosed a net income of $3,482,004.88 and a total tax liability of $435,250.61.

In computing said net income the plaintiff deducted the amount of $78,807.80 as being interest paid during the year 1922 on joint-stock land bank bonds of the First Trust Joint Stock Land Bank of Chicago and the First Trust Joint Stock Land Bank of Dallas, but said deduction was disallowed by the Commissioner of Internal Revenue.

3. Plaintiff paid to said collector of internal revenue said amount of $435,250.61 as follows:

March 15, 1923	$108,812.65
June 13, 1923	108,812.66
September 15, 1923	108,812.65
Credit in 1926, ITA 19366 (overassessment 1919)	49,827.89
Credit in 1926, ITA 19366 (overassessment 1920)	53,789.97
May 22, 1926	663.65
June 1, 1926	4,531.14
	435,250.61

4. Subsequent to the filing of said completed consolidated return, plaintiff, on or about March 5, 1924, filed with the collector of internal revenue at Chicago, Illinois, a claim for credit and on or about March 12, 1925, filed a claim for refund.

On or about November 11, 1927, the aforesaid claim for refund was rejected and the aforesaid claim for credit was partially allowed in the amount of $4,466.53, but this allowance was not based upon any ground set up or alleged in this suit.

Plaintiff's total tax liability for the year 1922 was redetermined to be $430,784.08, which amount is less than the tax previously paid by $4,466.53. A certificate of overassessment was issued therefor, and the said amount of $4,466.53 was refunded on Schedule FT; 27612.

5. On or about November 25, 1927, plaintiff filed a claim for refund in the amount of $9,124.70 based upon the disallowance as a deduction from income of interest paid by the First Trust Joint Stock Land Bank of Chicago and the First Trust Joint Stock Land Bank of Dallas.

In the determination of taxable net income for said year the Commissioner of Internal Revenue allowed as a deduction, in respect of certain intercompany transactions in [fol. 13] connection with interest on said joint-stock land bank bonds the amount of $5,810.25 which item plaintiff concedes is not deductible provided the interest paid by said joint-stock land banks on their outstanding joint-stock land bank bonds is held to be a deductible item.

Said claim for refund was denied by the Commissioner of Internal Revenue by letter dated February 14, 1928, for the reasons set forth in said letter as follows:

"It is held that farmers' first mortgage notes executed to joint-stock land banks are issued under the provisions of the farm loan act of 1916, that they are securities in the contemplation of Section 213 (b) (4) (b) of the revenue act of 1921; that they were acquired by purchase, and that the interest on bonds issued to furnish proceeds for their purchase is interest on an indebtedness incurred to purchase or carry obligations or securities; the interest upon which is wholly exempt from taxation under (Title II of the revenue act of 1921, and as such is not deductible as an expense."

6. The alleged interest expense was incurred as hereinafter more particularly shown:

The First Trust Joint Stock Land Bank of Chicago and the First Trust Joint Stock Bank of Dallas, which were organized under the Federal farm loan act of July 17, 1916, issued to and/or had outstanding in the hands of the public in the year 1922 their joint-stock land bank bonds, respectively, on which interest was paid and/or accrued in the year 1922, in the aggregate sum of $78,807.80, part of which was the intercompany transaction in the amount of $5,810.25, leaving a balance paid or accrued of $72,997.55. As security for the payment of said joint-stock land bank bonds said joint-stock land banks, as provided in the Federal farm loan act, deposited with the proper farm loan registrars farmers' promissory notes evidencing loans to said farmers, which in turn were secured as to payment by said farmers' first mortgages on their farms.

The proceeds coming into the hands of said joint-stock land banks from the issuance and sale of said joint-stock land bank bonds were used by said joint-stock land banks to make new additional loans to farmers, which new loans, made from the proceeds of said joint-stock land bank bonds issued and/or outstanding in 1922, were made in each instance in consideration of the making and delivery by the borrowing farmers, respectively, of their promissory notes secured as to payment by first mortgages on their farms.

All of said loans, respectively, and the farmers' notes and mortgages, respectively, evidencing said loans, were designed to be and were of such a nature as to comply with (1) all the terms, conditions, restrictions, limitations, and requirements specified in the Federal farm loan act, as requisite to qualify said loans, notes, and mortgages, as "first mortgages" in contemplation of said act, so as to make them available as collateral security against the issue of joint-stock land bank bonds; and (2) all terms, conditions, restrictions, limitations, and requirements, statutory or otherwise, specified in the laws of the State in which the farm which was the subject of the particular loan was located (to wit, the States of Illinois, Iowa, Texas, and Oklahoma, respectively), as requisite to qualify said loans, notes, and mortgages as valid and subsisting first mortgages, in contemplation of such laws. Said notes and mortgages contain an agreement providing for the repayment of the loan on the amortization plan, as provided in section [Vol. 14] 12, second, of the Federal farm loan act, and such agreement in respect of each note and/or mortgage was such that the respective note and/or mortgage was not extinguished within a period of less than thirty-three years, except, of course, at the option of the borrower.

The interest received by the plaintiff on such farmers' notes and mortgages was not taxable as income to the plaintiff and was not so taxed in respect of plaintiff's return for the year 1922.

7. Plaintiff has at all times borne true allegiance to the Government of the United States, and has not in any way voluntarily aided, abetted, or given encouragement to rebellion against said Government; is the sole and absolute owner of the claim herewith presented; and has made no transfer or assignment of said claim or any part thereof.

Conclusion of Law

Upon the foregoing special findings of fact, which are made part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is not entitled to recover and its petition is therefore dismissed.

Judgment is rendered against plaintiff for the cost of printing the record herein, the amount thereof to be ascertained by the clerk and collected by him.

Opinion

Williams, Judge, delivered the opinion of the court:

Decision in this case was originally rendered in favor of the plaintiff on May 6, 1929. A motion for new trial having been made by the defendant and granted, and the judgment vacated and the findings of fact and opinion withdrawn, the case is again before the court for consideration on merits.

The plaintiff seeks to recover the sum of $9,124.70, an alleged overpayment of its income and profits taxes for the year 1922.

The facts have been stipulated and the sole question to be determined is one of law, that is, whether or not interest paid by joint-stock land banks on their joint-stock land bank bonds is deductible from income, under section 234 (a) (2) of Title II, of the revenue act of 1921, 42 Stat. 254.

The plaintiff, the First National Bank of Chicago, filed for the year 1922 a consolidated income and profits tax return, which return consolidated the income of plaintiff and the following affiliated corporations:

First Trust and Savings Bank, an Illinois corporation, Chicago, Illinois.

First National Investment Company, now First-Chicago Corporation, an Illinois corporation, Chicago, Illinois.

National Safe Deposit Company, an Illinois corporation, Chicago, Illinois. First Trust Joint Stock Land Bank of Chicago, a joint-stock land bank organized under the Federal farm loan act of 1916, with its principal office in the city of Chicago, Illinois.

First Trust Joint Stock Land Bank of Dallas, a joint-stock land bank organized under the Federal farm loan act of 1916, with its principal office in the city of Dallas, Texas. [fol. 15] In computing its income plaintiff deducted the amount of $78,807.80, this amount being interest paid during the year 1922 on joint-stock land bank bonds of the First Trust Joint Stock Land Bank of Chicago and the First Trust Joint Stock Land Bank of Dallas.

The Commissioner of Internal Revenue disallowed said deduction. A timely claim for refund was filed and rejected, and this action is brought for the recovery of the amount claimed on account of the disallowance of the right to deduct said interest, to wit, $9,124.70.

The First Trust Joint Stock Land Banks of Chicago and of Dallas were organized under the Federal farm loan act of July 17, 1916, 39 Stat. 360, and the bonds in question were issued and sold to the public in accordance with the provisions of said act, and they were secured as required by said act by the deposit, with the proper farm loan registrars, of farmers' promissory notes, which in turn were secured by first mortgages on the borrowing farmers' land. The proceeds derived by the joint-stock land banks from the issue and sale of said bonds were used in making new loans to farmers, which were secured in precisely the same manner as hereinabove stated. Interest received by plaintiff on the farmers' notes and mortgages was not taxable as income, and was not so taxed for the year 1922. Interest on the said joint-stock land bank bonds is not taxable as income and the holders of such bonds were not taxed on such income for the year 1922. The farmers' notes and mortgages provide for the payment of the loan on an amortization plan, as provided in section 12 of the Federal farm loan act, covering a period of thirty-three years, except, at the option of the borrowing farmer, it may be paid sooner. Joint-stock land banks are not permitted to engage in any business, except that of making loans to farmers and issuing bonds.

Section 234 of the revenue act of 1921 reads:

"(a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * * *

"(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities * * * the interest upon which is wholly exempt from taxation under this title."

Neither the Joint Stock Land Bank of Chicago, nor the Joint Stock Land Bank of Dallas had any taxable income for the year 1922, and neither of these institutions as such paid income or profits taxes for that year. The question of the deductibility of the interest paid by them on their out-

standing bonds arises solely because of their affiliation during the year with plaintiff and other corporations having taxable incomes, and the deduction is sought from their consolidated income. This fact, of course, does not affect the right of the plaintiff to have the deduction claimed if the joint-stock land banks with which it was affiliated during the year would have had a right to the deduction had they filed individual returns for the year.

Joint-stock land banks, not being permitted to engage in any business, except that of making loans to farmers and issuing their bonds to procure the necessary funds therefor, [fol. 16] do not ordinarily have income subject to taxation, and so long as such banks operate as individual and separate institutions, it can not make the slightest difference whether they have or do not have the right to deduct the interest paid on their bonds. Their income is tax exempt, and consequently the right to make deductions therefrom means nothing. When, as in the instant case, joint-stock land banks are affiliated with banking corporations that do have taxable incomes, the question assumes importance, as the interest deduction, if allowed, reduces the tax liability of the affiliated group—even then, however, it in no way affects the joint-stock land banks included in such consolidation. They have no taxable income and they pay no taxes. The plaintiff contends, (1) that the interest deduction denied in respect of indebtedness incurred or continued to purchase or carry obligations or securities, the interest upon which is wholly exempt from taxation under this title, has no reasonable relation or logical application to indebtedness incurred by joint-stock land banks on their bonds to provide funds to make loans to farmers on their "first mortgages" in contemplation of the Federal farm loan act, and there is no reasonable ground on which to attribute any contrary intent to Congress. (2) That the face value construction of the exception clause, to the effect that such indebtedness of joint-stock land banks is not "indebtedness incurred or continued to purchase or carry obligations or securities, the interest upon which is wholly exempt from taxation under this title," is simple, direct, and unambiguous. (3) To class a joint-stock land bank indebtedness on its bonds as "indebtedness incurred or continued to purchase or carry obligations or securities, the interest

upon which is wholly exempt from taxation under this title," imputes to the Congress an intent which is inconsistent with the clear intent manifested by the Congress in the Federal farm loan act.

It is particularly urged that—

(a) The loaning of money by joint-stock land banks to farmers on their "first mortgage" security is not a "purchase or carry" in contemplation of the interest deduction exception clause, section 234 (a) (2), and consequently the exception is not applicable to such indebtedness of joint-stock land banks represented by their bonds.

(b) The indebtedness of joint-stock land banks represented by their bonds is not incurred or continued to "purchase or carry obligations and securities the interest upon which is wholly exempt from taxation under this title" in that the only possible exemption under this title would be on the theory that "first mortgage" notes executed to joint-stock land banks, evidencing loans to farmers, are "securities issued under the provisions of the Federal farm loan act" in contemplation of section 213 (b) (4) (b), and such "first mortgage" notes are not "securities issued under the provisions of the Federal farm loan act.

(c) "Obligations or securities" in contemplation of the interest deduction exception clause are, in any event, only such obligations or securities as are designated in the interest exemption clause, section 213 (b) (4). Farmers' mortgage notes evidencing such loans to them by joint-stock land banks do not fall within the "obligations" or [fol. 17] "securities" designated in the interest exemption clause, section 213 (b) (4) (b). Consequently, the indebtedness of the joint-stock land banks incurred to provide funds to make such loans to farmers is not incurred to purchase or carry "obligations or securities" in contemplation of section 234 (a) (2), and therefore the interest on such indebtedness is deductible, irrespective of the source of the exemption granted in respect of interest paid to joint-stock land banks on such farmers' first mortgage notes.

(d) The interest deduction exception phrase "exempt from taxation under this title" is the equivalent of "exempt (from taxation) under this title," referring to ex-

emptions contained in interest exemption section 213 (b), (4) (b) and applies as set forth in (b) above.

Bonds issued by joint-stock land banks constitute "indebtedness" of such banks. This indebtedness is incurred and continued by the banks to procure funds to loan to farmers on their notes secured by first mortgages, the interest of which is wholly tax exempt.

The question is, Does this "indebtedness" of the joint-stock land banks constitute an indebtedness incurred or continued to purchase or carry the notes and first mortgages of borrowing farmers?

The plaintiff contends that it does not. That lending money to farmers on long-time loans, secured by notes and mortgages, is not the purchasing and carrying of such notes and mortgages.

"Purchase" is defined by Webster's New International Dictionary as—

"(2) Law: Technically, to acquire (real estate) by any means whatever other than descent or inheritance.

"(3) To obtain (anything) by paying money or its equivalent; the acquisition of title to, or property in, anything for a price; buying for money or its equivalent."

By the New Standard Dictionary as—

"Purchase: (1) To obtain or secure as one's own by paying or promising to pay a price. (3) Law: (1) To acquire (property) by one's own act or agreement, as distinguished from the act or mere operation of law.

"Synonym: Acquire; bargain for; barter for; get; obtain; procure; secure."

"The term 'purchase' in its general signification, and which is the legal sense of it, includes all modes of acquiring property except by descent, and it embraces a devise." McCartee v. Orphans' Asylum (N. Y.), 9 Cow. 437.

"The payee of a note is the purchaser thereof, if he advances money or otherwise parts with valuable consideration therefor." 8 C. J. 468, 469, 470.

The word "carry" is defined in Words and Phrases, vol. I, 2d series, page 577, as follows:

"The term 'carry' as used in a contract by which one of the parties to a contract for the purchase of a patent right agreed to 'carry' the interest of another party who was to have a part interest therein, means 'advance' the money to

pay his interest. (Mann v. Urquhart, 116 Sw. 219, 222.)"

Webster's International Dictionary contains the following definition:

[fol. 18] "16 Com. To bear the charges or burden of holding or having, as stocks, merchandise, etc., from one time to another; to keep on one's books as a debtor * * * to bear * * * to support."

New Standard Dictionary defines the word "carry":

"10. To keep on hand; maintain; keep up; support; hold; as to carrying a full stock; to carry life insurance."

The words purchase or carry, in our opinion, unless they are to be given a technical meaning different from that in which they are ordinarily used, are apt words and characterize precisely the acquisition of and the holding of farmer's notes and mortgages by joint-stock land banks. We think, therefore, the bonds of joint-stock land banks constitute indebtedness incurred and continued to purchase and carry the tax-exempt notes and mortgages of farmers executed and issued under the provisions of the Federal farm loan act of 1916.

The plaintiff next contends that the notes and mortgages of farmers given and executed under the provisions of the Federal farm loan act are not "obligations" or "securities" within the meaning of the exception to the interest-deduction clause of section 234 of the 1921 revenue act.

"Obligations is a generic word, and includes all kinds of contracts by which contracting parties bind themselves, and, in the absence of limiting words or the connection in which it is used, will be construed in its generic sense." (Sinton v. County of Carter, 23 Fed. 535.)

"The word 'obligations' has a very broad and comprehensive legal signification and embodies all instruments of writing, however informal, whereby one party contracts with another for the payment of money or the delivery of specific articles. Bouvier's Law Dictionary." State v. Campbell, 103 N. C. 344; Morrison v. Lovejoy, 6 Minn. 353 (Gil. 224).

"Securities" is defined by standard authorities as follows:

Webster's New International Dictionary:

"Security—That which secures or makes safe. Specif.: something given, deposited, or pledged; to make secure or

certain; or certain the fulfillment of an obligation; the payment of a debt. Specif.: An evidence of debt or of property, as a bond; a stock certificate or other instrument, etc.; a document giving the holder the right to demand and receive property not in his possession."

Abbott's Law Dictionary:

"Securities (plural)—Is in use as a general term for written assurances for payment of money; evidences of debt."

Black's Law Dictionary:

"Security—The term is usually applied to an obligation, pledge, mortgage, deposit, lien, etc.; given by a debtor in order to make secure the payment or performance of his debt, by furnishing the creditor with a resource to be used in case of failure in the principal obligations."

If the language of the interest-deduction clause, and the exception therein, left any doubt whatever, that the first mortgage notes are securities, that doubt is completely removed by the plain language of the Federal farm loan act under the provisions of which such first mortgages are ac- [fol. 19] quired by joint-stock land banks, as they are clearly designated in the act itself as securities.

Section 18 of the act provides:

"That any Federal land bank or joint-stock land bank, which shall have voted to issue farm loan bonds under this act, shall make written application to the Federal Farm Loan Board, through the farm loan registrar of the district, for approval of such issue. With said application said land bank shall tender to said farm loan registrar as collateral security first mortgages on farm lands qualified under the provisions of section twelve, section fifteen, or section sixteen of this act, or United States Government bonds, not less in aggregate amount than the sum of the bonds proposed to be issued. Said bank shall furnish with such mortgages a schedule containing a description thereof and such further information as may be prescribed by the Federal Farm Loan Board.

"Upon receipt of such application said farm loan registrar shall verify said schedule and shall transmit said application and said schedule to the Federal Farm Loan Board, giving such further information pertaining thereto as he may possess. The Federal Farm Loan Board shall

forthwith cause to be made such investigation and appraisement of the securities tendered as it shall deem wise, and it shall grant in whole or in part, or reject entirely, such application."

While bonds of the Government of the United States are authorized to be tendered and used as collateral security for farm-loan bonds, it is a matter of common knowledge that they are not so used by joint-stock land banks for that purpose to any appreciable extent.

The record discloses that farmers' notes and first mortgages were the only collateral security tendered by the Joint Stock Land Banks of Chicago and Dallas, with their various applications to the Federal Farm Loan Board for authority to issue farm-loan bonds. They were the only securities which the Federal Farm Loan Board under the provisions of section 18 of the Federal farm loan act could investigate and appraise in passing upon and approving applications to issue the bonds in question. If plaintiff's contention is correct that these notes and first mortgages are not securities within the meaning of the Federal farm loan act no investigation or appraisement of securities tendered was ever made by the Federal Farm Loan Board in passing upon the applications of the Joint Stock Land Banks of Chicago and Dallas to issue farm-loan bonds, because no securities were ever tendered. To direct the Federal Farm Loan Board to investigate and appraise the securities tendered as collateral security for farm-loan bonds, and then say that farmers' first notes and mortgages, which constitute the only collateral security tendered, as was the case here, are not securities within the meaning of the Federal farm loan act amounts to an absurdity. The framers of a statute are presumed to know and understand the meaning of the words used, and where the language used is clear and free from ambiguity, and not in conflict with other parts of the same act, the courts must assume the legislative intent to be what the plain meaning of the words used import.

[fol. 20]. That Congress intended to make the notes and first mortgages of borrowing landowners, securities, by the language used in section 18 of the Federal farm loan act, is quite clear from other provisions of the act and by the essential functions they perform in the whole scheme of the

joint-stock land bank system. Farmers' notes and first mortgages are repeatedly referred to in the act as collateral security, and in section 26 of the act they are placed on the same basis and given the same legal status as the farm-loan bonds issued under the provisions of the act.

Section 26 reads:

"First mortgages executed to Federal land banks, or to joint-stock land banks, and farm-loan bonds issued under the provisions of this act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation."

The farm-loan bonds are evidences of indebtedness of the joint-stock land banks. The farmers' notes and mortgages are evidences of indebtedness of borrowing farmers. They are of equal importance in the operation of joint-stock land banks, and they are each made instrumentalities of the Government of the United States in the act providing for the creation of such banks.

The function of these two instrumentalities in the operation of the joint-stock land bank system is well stated in an opinion of Attorney General T. W. Gregory (Opinions of Attorneys General, Volume 31, 105):

"I do not deem it necessary to analyze the act in detail. It is sufficient to say that the mortgages and farm-loan bonds are of the very essence of the system created by it. The original capital of the Federal land banks is to be loaned, through the agency of national farm-loan associations, to bona fide cultivators of the soil on first mortgages on farm lands. When a sufficient amount in such mortgages has accumulated, they are to be turned over to a 'registrar' appointed by the Farm Loan Board, and with the approval of the board, farm-loan bonds are issued by the land bank and sold. With the proceeds further loans are made on mortgages, which mortgages in their turn become the basis of an additional issue of bonds. This continuous flow and reflow of mortgages and bonds constitutes the prime function of the whole system."

The provisions of section 18 of the Federal farm loan act designating these instrumentalities of the Government of

the United States (farmers' notes and first mortgages) securities are in harmony with the manifest intent of the other provisions of the act and of the whole scheme underlying the creation and operation of joint-stock land banks.

We are of the opinion that the notes and first mortgages owned and held by joint-stock land banks, and used by them as collateral security for the payment of their bonds, are securities under the provisions of the Federal farm loan act of 1916, and that as such the interest upon them is specifically exempted from taxation under section 213 (b) (4) of the revenue act of 1921. It follows that under the provisions of section 234 (a) (2) of that act the interest paid by [fol. 21] joint-stock land banks on their farm-loan bonds, which is indebtedness incurred, and continued to purchase and carry such securities, come within the exception and is not deductible from income.

The plaintiff urges the deduction of the interest paid on its farm-loan bonds should not be denied for the reason that such denial tends to thwart or defeat the purposes sought to be attained in the enactment of the Federal farm loan act, to wit, to enable farmers to obtain long-time loans on the security of their lands at reasonable rates of interest. It is contended denial of the deduction sought would impose a burden on the joint-stock land banks contrary to the intent of the Federal farm loan act and not contemplated in the exception to the interest-deduction clause of section 234 (a) (2).

Three agencies are created by Congress under the provisions of the Federal farm loan act to carry out the purposes of the act, the Federal farm banks, national farm-loan associations and joint-stock land banks. The national farm-loan associations are local organizations of landowners who desire to borrow money on their lands from Federal farm banks.

The provisions of the act provide that the Continental United States, excluding Alaska, shall be divided by the Federal Farm Loan Board into twelve Federal land-bank districts, in each of which districts shall be established one Federal farm-land bank. Each Federal farm bank is required to have a minimum capital stock of $750,000.00. The capital stock is divided into shares of five dollars each and may be subscribed for and held by any individual, firm, or

corporation, or by the government of any State or of the United States. It is provided that in case the capital stock of a Federal farm bank is not subscribed within thirty days after the books of such banks are opened for subscription for its stock, it shall be the duty of the Secretary of the Treasury to subscribe the balance thereof on behalf of the United States. An appropriation of one hundred million dollars was provided in the act for the purpose of carrying into effect the provisions of the act. Practically all the capital stock of the twelve Federal land banks was subscribed by the Secretary of the Treasury and carried by the Government.

Joint-stock land banks are organized on a basis entirely different from that of the Federal farm banks. The Government of the United States is expressly prohibited from subscribing to or purchasing any of their capital stock.

There are no requirements as to the location of joint-stock land banks nor any limitation on the number that may be organized. They may be organized on the application of any number of natural persons not less than ten and with a capital stock not less than $250,000.00.

It is true, as contended by the plaintiff, the creation of joint-stock land banks was authorized on the theory that they would serve as useful agencies in accomplishing the primary purposes of the farm loan act.

However, the sole purpose of the stockholders of joint-stock land banks is to make profits out of their invested capital. It was the intent of the farm loan act that these banks should be profit-making institutions. Unless investors could make profits there would be no inducement to them to furnish the capital required for the organization of such banks, and obviously they would not be or-
[fol. 22] ganized. In order that they might be profit-earning institutions, Congress in the farm loan act conferred on joint-stock land banks benefits and privileges never before given to any corporation, agency, or institution financed by private capital and organized and operated for profit.

Joint-stock land banks are permtited to do two things, and nothing else—loan money to farm owners, secured by first mortgages on their land, and to issue and sell farm-loan bonds.

The interest received by the banks on the notes and mortgages of borrowing farmers to whom they loan money is

exempt from all taxation. The interest on their outstanding bonds is exempt from taxation. They are permitted to receive interest on loans to farmers to the extent of one per cent in excess of the rate of interest paid by them on their bonds. Being permitted to issue bonds and make loans to fifteen times the amount of their capital stock, they have a possible maximum annual profit of fifteen per cent on their invested capital, less expenses of operation. In addition to this they are exempted from many of the restrictions imposed in the farm loan act on the Federal farm banks as to interest, the amount of money that may be loaned to a single borrower, the per cent of the valuation that may be loaned upon, etc.

It will be seen that these joint-stock land banks, so far as their stockholders are concerned, are corporations which are organized for profit, and when managed and operated in the manner contemplated in the farm loan act they can not be otherwise than highly profitable.

The value of the privileges and exemptions they enjoy under the law when compared with investment corporations organized as a private business for the purpose of making farm loans is strikingly evident.

The interest received by a private corporation on its loans would be taxable, and if it issued and marketed bonds upon its loans to obtain more money to reloan, the income from its bonds would be subject to Federal taxation, and both the principal and the interest would be subject to State taxation against the holders thereof.

It was believed at the time of the enactment of the farm loan act, as shown by reports of committees in the House and Senate, and by the debates in both Houses of Congress, that these exceptional advantages and benefits would enable the joint-stock land banks to practically monopolize the farm-loan investment field. If these banks have not been as prosperous in all cases as was anticipated by Congress at the time the law was enacted, as has been intimated in argument, is not a matter for consideration here. The undoubted purpose of Congress was to create a system of rural credits that would insure long-term loans to farm owners at a low rate of interest. To assist in accomplishing this purpose Congress gave to the joint-stock land banks privileges and exemptions that would make invest-

ment in the capital stock of the banks inviting and profitable.

These liberal provisions of the farm loan act, it is contended, indicate the intent of Congress, that interest paid by these banks on their farm loan bonds does not come within the intent and meaning of the exception to the interest-deduction clause of section 234 (a) (2) of the revenue act of 1921, and that holding it does come within the exception is contrary to the manifest intent and purposes of the farm loan act itself. We do not agree with this contention and we find nothing in the provisions of the farm [fol. 23] loan act to indicate any intent on the part of Congress that joint-stock land banks should be given any benefits or exemptions other than those specifically set out in the act. Congress exempted from taxation of every kind and character the income derived by these banks on loans made by them to landowners and also made the interest on the bonds issued by them wholly tax exempt to the holders thereof in every respect, and made it possible for them to earn profits on fifteen times the amount of their invested capital. These generous provisions afford no valid or logical reason, in our opinion, for construing the meaning of section 234 (a) (2) of the revenue act of 1921 in any manner other than by giving to the language of the clause the effect which the plain and obvious meaning of the words used convey. The fact that Congress in the farm loan act gave generous and unusual benefits and exemptions to joint-stock land banks does not indicate the purpose or intent of Congress that they should enjoy other benefits and exemptions not given in the act.

Construing the language of the exception to the interest-deduction clause in section 234 (a) (2) to mean what the words used import deprives the plaintiff of no benefit the provisions of the farm loan act accord to it. On the other hand, to give the language used the construction contended for by the plaintiff would give to it a benefit nowhere granted in the act.

Plaintiff contends that the purpose of the exception in the interest-deduction clause of section 234 (a) (2) was to forestall deliberate tax avoidance by taxpayers. That is, it was to prevent taxpayers incurring indebtedness to purchase tax-exempt securities and thereby get in addition to

the exemption of interest received on such securities a deduction of the interest paid on the indebtedness so incurred; that the interest deduction should be disallowed only in those cases where the indebtedness is incurred with a view to tax avoidance. The plaintiff claims the indebtedness incurred by joint-stock land banks on their bonds is not an indebtedness incurred with a view to tax avoidance, and that the banks are therefore entitled to deduct the interest paid on such indebtedness.

There is no doubt that to forestall tax avoidance was one of the purposes sought to be accomplished in the enactment of the exception in the interest-deduction clause. However, the congressional intent to deny the interest deduction only where the indebtedness was incurred by the taxpayer for the purpose of tax avoidance is not expressed either directly or indirectly in the language used in the exception. The language of the interest-deduction clause including the exception is both explicit and comprehensive.

"It is a fundamental rule of statutory construction that the intent of the lawmaker is to be found in the language of the statute." (Goldenberg v. United States, 168 U. S. 95.)

"To get at the thought or meaning expressed in a statute, * * *. the first resort, in all cases, is to the natural significance of the words, in the order of the grammatical arrangements in which the framers * * * have placed them. If the words carry a definite meaning which involves no absurdity, nor any contradiction of other parts of the instrument, then that meaning apparent on the face must be accepted." (Lake Co. v. Rollins, 130 U. S. 670.)

There is no ambiguity in the language used in section 234 (a) (2). The meaning of the words used is clear and [fol. 24] free from doubt. Deduction may be had of "all interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title," as income to the taxpayer.

The language of the exception is general and in our opinion denies to a taxpayer the right of deduction of interest paid on indebtedness incurred or continued for the

purpose of enabling the taxpayer to purchase or carry tax-exempt obligations or securities without regard to the reasons actuating the taxpayer in incurring such indebtedness.

The construction urged by the plaintiff if adopted by the court would in effect require the court to rewrite the exception to the interest-deduction clause by adding the words, "where such indebtedness is incurred with a view to tax avoidance."

That would be the exercise of a legislative power, which under the constitution the court does not possess. Courts can not, by interpretation, change the plain meaning of a statute on the theory that there existed in the minds of its framers a latent unexpressed intent not conveyed in the language used.

We can not assume, there being nothing in the language used to warrant such assumption, that the full intent and purpose of Congress are not clearly expressed in the language of section 234 (a) (2) of the revenue act of 1921. Many of the leading members of both the Senate and House who framed the revenue act of 1921 were Members of Congress in 1916 and participated in framing and passing the Federal farm loan act. They were perfectly familiar with its provisions and its purposes and had they intended that the exception in the interest-deduction clause of section 234 (a) (2) should not apply to interest paid by joint-stock land banks on their indebtedness incurred to purchase and carry the farmers' tax-exempt notes and first mortgages, which are securities under the provisions of the farm loan act, they would, we think, have expressed such intent by the use of appropriate language.

It is our opinion, therefore, that plaintiff's petition should be and it is hereby dismissed. It is so ordered.

Littleton, Judge; Green, Judge; Graham, Judge; and Booth, Chief Justice, concur.

[fol. 25] VI. JUDGMENT

At a Court of Claims held in the City of Washington, on the 3rd day of March, A. D., 1930, judgment was ordered to be entered as follows:

Upon the special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is not entitled to recover, and its petition is therefore dismissed.

[fol. 26] Clerk's certificate to foregoing transcript omitted in printing.

Endorsed on cover: File No. 35,036. Court of Claims. Term No. 905. The First National Bank of Chicago, a national banking association, petitioner, vs. The United States. Petition for writ of certiorari and exhibit thereto. Filed May 16, 1930. File No. 35,036.

Supreme Court of the United States

Order Allowing Certiorari—Filed June 2, 1930

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(4640)

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CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1929.

No. ~~985~~ 124

THE FIRST NATIONAL BANK OF CHICAGO, A NATIONAL BANKING ASSOCIATION, *Petitioner*,

vs.

THE UNITED STATES.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

HAROLD V. AMBERG,
Attorney for Petitioner.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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Supreme Court of the United States

OCTOBER TERM, 1929.

No. 905.

THE FIRST NATIONAL BANK OF CHICAGO, A NATIONAL BANKING ASSOCIATION, *Petitioner*,

vs.

THE UNITED STATES.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

STATEMENT OF CASE.

Petitioner seeks to have this Court review a judgment of the Court of Claims which was adverse to your petitioner (see R. p. 16).

Briefly, the essential facts, which are stipulated, are as follows: The First National Bank of Chicago filed for the year 1922 a consolidated income tax return, including therein the returns of its two affiliated Joint Stock Land Banks, the First-Trust Joint Stock Land

Bank of Chicago and the First-Trust Stock Land Bank of Dallas. In the suit in the Court of Claims The First National Bank of Chicago sought to recover $9,124.70, representing an additional tax assessed and collected as a result of the disallowance by the Government of a deduction of the interest paid by these Joint Stock Land Banks on their outstanding bonds. These Joint Stock Land Banks, as contemplated in the Federal Farm Loan Act, issued and sold their bonds for the purpose of creating a fund to make, and out of which were made, loans to farmers on the security of first mortgages on their respective farms. These farmers' notes and mortgages were designed to be, and were, of such a nature as to comply with (1) all the terms, conditions, restrictions, etc. of the Federal Farm Loan Act as requisite to qualify said loans as "first mortgages" in contemplation of said Act, so as to make them available as collateral security against the issue of additional Joint Stock Land Bank Bonds, and (2) all terms, conditions and restrictions, statutory or otherwise, specified in the laws of the States of issuance, respectively.

Section 26 of the Federal Farm Loan Act provides:

> "First mortgages executed to Federal Land Banks, or to Joint Stock Land Banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal and local taxation."

STATEMENT OF ISSUE.

The issue and the statutes involved are set forth in the petition for certiorari. Briefly, the petition con-

tends that in computing the net income of these Joint Stock Land Banks the interest paid by them on their bonds is deductible under the general provision of Section 234 (a) (2) of the Income Tax Law of 1921,—permitting the deduction of interest paid on indebtedness. The United States contends that this interest falls within the exception clause of said Section 234 (a) (2), which denies deduction of interest on "indebtedness incurred or continued to purchase or carry obligations or securities the interest upon which is wholly exempt from taxation under this title" (R. p. 2). In other words, the United States contends that the indebtedness of a Joint Stock Land Bank evidenced by its bonds is incurred for the purpose of purchasing or carrying farmers' "first mortgages" which are "obligations or securities the interest upon which is wholly exempt from taxation under this title" because they (first mortgages) are securities "exempt from taxation under this title", inasmuch as they fall within subsection (b) of Section 213 (b) (4) of the Income Tax Law of 1921. Section 213 (b) (4) is the interest exemption section, so-called, and provides that the interest on specified securities "shall be exempt from taxation under this title," among them being "securities issued under the provisions of the Federal Farm Loan Act." (R. p. 2) Your petitioner contends that this indebtedness of Joint Stock Land Banks falls within neither the spirit or purpose nor the letter of the exception clause of Section 234 (a) (2). The Court of Claims in its original opinion, which was, one dissenting, in favor of the plaintiff, apparently adopted the view that this indebtedness was not within the intended scope of the exception clause, but later the Court, judging from its subsequent opinion, felt that it

had been under a misapprehension in respect of the facts, some of which it assumed. The United States has not addressed itself to the question whether this indebtedness of Joint Stock Land Banks falls within the spirit and purpose of the exception clause but urges that it falls within the letter thereof. The Court of Claims, in its unanimous second opinion, held that the indebtedness falls within the letter of the exception clause, because the indebtedness is incurred for the purpose of purchasing or carryiny farmers' first mortgages, which are "exempt from taxation under this title" (under Section 213 (b) (4) (b) of the Income Tax Law)—as falling within "securities issued under the provisions of the Federal Farm Loan Act." The petitioner contends that the indebtedness of Joint Stock Land Banks evidenced by their bonds is not incurred for the purpose of purchasing or carrying the farmers' mortgage notes and that, in any event, the farmers' first mortgage notes do not fall within "securities issued under the provisions of the Federal Farm Loan Act".

The United States urged, in addition, an alternative construction of the phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title". This contention the Court of Claims apparently thought it unnecessary to consider. The petitioner also raised the question of the constitutionality of the exception clause. This the Court of Claims ignored in its opinion.

These questions will be considered briefly below in the argument.

REASONS FOR ALLOWING THIS PETITION.

As set forth in the Petition for Certiorari, this is a "class" case of general interest which presents precisely a single question of law, involving the application of a definite set of facts to the provisions of a Federal statute (assuming the constitutionality and application of the statute). The constitutionality and application of the statute is also involved. A decision of this question will control the decision of similar suits, pending in the Board of Tax Appeals and a District Court, and also many claims and questions of tax liability which have not yet reached the stage of litigation, but which, in due course, would be litigated. The statutes at issue have remained unchanged since the Income Tax Law of 1921 and, therefore, the tax question involved is recurrent in each year in respect of each taxpayer. Your petitioner, on its best information and belief, represents that this issue involves, at least, twelve and possibly more taxpayers and pertains to their respective income tax returns over a period of ten years in a varying number of years. Further, your petitioner represents that the amount of tax liability involved is relatively appreciable.

Your petitioner further represents that there is a public interest, inasmuch as this question indirectly affects the Land Bank System originated by Congress. This public interest is manifested by the suggestion of the Federal Farm Loan Bureau of the Treasury Department to the Department of Justice that a final decision in this case of the question at issue would be desirable.

Furthermore, in the case of *Nauts vs. Slayton*, 36 Fed. (2d) 145, (decided December 6, 1929), the Circuit Court of Appeals for the Sixth Circuit held the

exception clause to be unconstitutional insofar as it was applied to indebtedness incurred to purchase Municipal bonds as, in effect, imposing a tax on Municipal bonds which was beyond the power of Congress. Based on principles of construction laid down by this Court in *National Life Insurance Co. vs. United States*, 277 U. S. 508, the exception clause would not be applicable to this indebtedness of Joint Stock Land Banks and the interest on their bonds would, therefore, be deductible. This Court, on April 28, 1930, granted a Petition for a Writ of Certiorari in the case of *Nauts vs. Slayton*, so the question of the constitutionality of the exception clause is pending before this Court.

The errors, which will be discussed below briefly in the argument, which the petitioner urges as grounds for the granting of a Writ of Certiorari and the reversal of the judgment of the Court of Claims are:

First: The Court of Claims erred in holding that the indebtedness of Joint Stock Land Banks evidenced by their bonds was indebtedness incurred for the purpose of purchasing or carrying "obligations or securities the interest upon which is wholly exempt from taxation under this title", in that it held that the indebtedness was incurred for the purpose of purchasing or carrying the farmers' first mortgages and, more particularly, that the farmers' "first mortgages" fall within the classification of "securities issued under the provisions of the Federal Farm Loan Act" (Section 213 (b) (4) (b)).

Second: The Court of Claims erred in ignoring the question of the constitutionality and application of the exception clause at issue.

SUMMARY OF ARGUMENT.

First Error Assigned.

Petitioner contends that in adopting the exception clause in respect of interest deduction the Congress had a definite purpose and, in contemplation thereof, fixed a definite limit to the scope of the exception clause, and that, incidentally, this Congressional intent in these respects is an essential guide in construing not only the spirit but the letter of the exception clause. Interest paid on indebtedness being uniformly allowed as a deduction in computing net income, the Congress must have had a particular purpose when it denied deduction of interest in respect of a particular type of indebtedness. This purpose was to discourage the borrowing of money by taxpayers in order to purchase a particular class of tax-exempt securities,—the taxpayer thereby getting the benefit of the exemption of the interest received on such tax-exempt securities and the deduction of the interest paid on the indebtedness so incurred. As the Senate Committee on Finance said, (Majority Report, 65th Cong. 3d Session-Senate Report No. 617, December 8, 1918, at p. 6), "*the limitation suggested above would operate to discourage this practice* except in the case of the latter issues of Liberty bonds" (Italics ours). The purpose of the exception clause is an essential guide in construing not only the spirit but the letter of the clause. *Holy Trinity Church vs. United States*, 143 U. S. 457, at p. 463; *Heidenfeld vs. Daney, Gold*, 93 U. S. 634, at p. 639.

Joint Stock Land Banks were authorized by the Congress, for one primary purpose, to wit, to loan money to farmers on first mortgage security and using

the resultant first mortgages as security to borrow additional money by issuing their bonds, and to loan the resultant funds to farmers, etc. As said by the Attorney General (*Opinions of Attorneys General, Vol. 31, 105*) "This continuous flow and reflow of mortgages and bonds constitutes the prime function of the whole system." Without further elaboration of argument, it is submitted that in loaning its money to the farmers a Joint Stock Land Bank is not indulging in the "practice" which Congress desired to discourage when it adopted the exception in respect of interest deduction. In fact, the bank is incurring indebtedness in the ordinary course of its business and in full conformity with the single purpose of its creation, as contemplated by the Congress.

The express language of the exception clause denies deduction only of interest on indebtedness incurred or continued for the purpose of purchasing or carrying not tax-exempt securities in general but a specific class of "obligations or securities", to wit, those "the interest upon which is wholly exempt from taxation under this title",—the Congress having, prior to the adoption of the exception clause, specified in Section 213 (b) (4) of the Income Tax Law of 1921 the "obligations" "or" "securities" "the interest upon" which "shall be exempt from taxation under this title". The mere coincidence of tax exemption on the income of securities purchased with borrowed money and the deductibility of interest on that borrowed money, does not bring the indebtedness within the exception clause. This obvious conclusion is supported by at least three rulings of the Income Tax Bureau, not quoted or cited here for the sake of brevity, and by the Board of Tax Appeals (*Appeal of Greenville Tex-*

tile & Supply Co., 1 B. T. A. 152) which held that indebtedness incurred to buy stock of a corporation is not within the clause because "in order to deny deduction it is not only necessary to construe the word 'securities' to mean 'stock' but to construe the word 'interest' to mean 'dividends'.".

These same rulings show that the indebtedness must be incurred for the *purpose* of purchasing or carrying such specified securities. The petitioner submits that that purpose of a Joint Stock Land Bank's borrowings on its bonds is to loan money to farmers and the acquisition of the farmers' first mortgages is purely incidental. The petitioner, furthermore, contends that even if the purpose be said to be to acquire the farmers' first mortgages, such acquisition is in no literal sense a "purchase or carry" in contemplation of the exception clause. Considering the context and purpose of the clause, to "purchase," it is submitted, obviously means "to buy" with an inference of simultaneous payment. In the 1917 Income Tax Law the words "to purchase" appeared alone. In the 1918 Act the words "or carry" were added, and the Senate Finance Committee (see p. 7 *supra*) states in respect of the 1918 exception clause:

> "This limitation is substantially the same as the one contained in the present law."

Without citation or elaboration of argument, past rulings of the Income Tax Unit, the history of the language of the clause "to purchase or carry," the sense of "carry" in financial transactions under consideration, indicate quite clearly that "carry" was added to supplement the word "purchase" and not to impart a new element, and was added merely to catch indebt-

edness incurred or continued to pay for a security previously purchased. In other words, in order to have a purchase or carry within the exception clause the purpose of the indebtedness must be in some way connected with a buying of and/or payment for these specified securities. "Carry" presupposes a "purchase."

Assuming, however, for the sake of the argument, that the indebtedness of a Joint Stock Land Bank evidenced by its bonds is incurred with a purpose "to purchase or carry" the farmers' "first mortgages," the farmers' first mortgages do not fall within the class of obligations or securities specified in the exception clause, to wit, "obligations or securities the interest upon which is wholly exempt from taxation under this title," because in order to fall within that clause they must fall within the phrase "securities issued under the provisions of the Federal Farm Loan Act,"—sub-section (b) of Section 213 (b) (4). This section specifies a certain type of obligations or securities the interest upon which is "exempt from taxation under this title." These are obligations of the United States, such as Treasury bonds, Treasury notes, Liberty bond issues, etc., obligations of States, Territories, political subdivisions thereof such as Counties, Cities, Special Assessment Districts, also obligations of the District of Columbia, also bonds issued by the War Finance Corporation, and "securities issued under the provisions of the Federal Farm Loan Act," which, the petitioner submits, are the bonds issued by Federal Farm Loan Banks and Federal Joint Stock Land Banks. The above obligations or securities are of the same dignity and wholly tax-exempt as to interest and available in the open market for purchase by taxpayers, which was the category of obligations or se-

curities the Congress had in mind in passing the interest exception clause.

The Court of Claims did not specifically in so many words say that the farmers' first mortgages are "securities issued under the provisions of the Federal Farm Loan Act," but held that the first mortgages were securities, generally speaking, that Section 18 of the Federal Farm Loan Act refers to them as securities and provides for their use as collateral security for Joint Stock Land Bank Bonds, that in Section 26 of the Federal Farm Loan Act the farmers' "first mortgages" and the Bank's bonds are put in the same category as "instrumentalities of the Government of the United States" (R. pp. 22-26) and that, therefore, "the notes and first mortgages owned and held by Joint Stock Land Banks, and used by them as collateral security for the payment of their bonds, are *securities under the provisions of the Federal Farm Loan Act of 1916, and that as such the interest upon them is specifically exempt from taxation under Section 213 (b) (4) of the Revenue Act of 1291*" (Italics ours). The petitioner submits that none of these reasons justifies the conclusion that the farmers' first mortgages fall within the phrase "securities issued under the provisions of the Federal Farm Loan Act." It may be granted that the farmers' first mortgages are securities, generally speaking, and are referred to as collateral security in Section 18 of the Federal Farm Loan Act and may be used as collateral security for the issuance of additional bonds. So, likewise, under said Section 18 of the Federal Farm Loan Act, are Liberty bonds referred to and may be likewise used. Clearly, Liberty bonds are not comprehended by the phase "securities issued under the provisions of the

Federal Farm Loan Act." The Court of Claims, apparently, answers this argument by saying that, as a matter of fact, Liberty bonds "are not so used by Joint Stock Land Banks for that purpose to any appreciable extent" (R. p. 24).

The origin of the phrase "issued under the provisions of the Federal Farm Loan Act" is obvious. It came from Section 26 of the Federal Farm Loan Act, which was adopted shortly before sub-section (b) was added to Section 213 (b) (4) of the Income Tax Law. Said Section 26 reads as follows:

> "First mortgages *executed to* Federal land banks, or to joint stock land banks, and *farm loan bonds issued under the provisions of this Act* shall be deemed to be instrumentalities of the Government of the United States etc." (Italics ours).

This indicates clearly that securities issued under the Federal Farm Loan Act mean Farm Loan Bonds, which, by definition in the Federal Farm Loan Act, are bonds issued by Federal Land Banks and Joint Stock Land Banks.

This Section 26 does, as the Court of Claims says, class both the farmers' first mortgages and bank's bonds as instrumentalities of the United States but clearly distinguishes the first mortgages as *executed to* the banks and the bank's bonds as *"issued under the provisions of* the Federal Farm Loan Act". This distinction is carried into the phrase "securities issued under the provisions of the Federal Farm Loan Act".

Again, the phrase "securites issued under the provisions of the Federal Farm Loan Act" was first used in the exemption section which had to do with exemp-

tions to individuals, and, obviously, Congress had no intention in the interest exception clause of denying interest deduction on indebtedness incurred by an individual taxpayer to buy a security which that taxpayer could not buy. They could buy, of course, Farm Loan Bonds.

Again, historically, but for the exemption contained in the Federal Farm Loan Act the farmers' "first mortgages" would be income taxable, which, of course, they would not be if they were "securities issued under the provisions of the Federal Farm Loan Act".

Again, the Income Tax Unit has ruled that the plain promissory note of a Joint Stock Land Bank issued by it to evidence a temporary borrowing does not fall within "securities issued under the provisions of the Federal Farm Loan Act" and the interest thereon is, therefore, not tax exempt (I. T. 1806, 1923). If a Joint Stock Land Bank's own note is not a "security issued under the provisions of the Federal Farm Loan Act," how can a mortgage note executed to the bank acquire the status of a "security issued under the provisions of the Federal Farm Loan Act"?

Again, even assuming that one would speak of the execution and delivery of an individual farmer's mortgage as an "issue" of that mortgage and that it may be that such a mortgage is issued in contemplation of the provisions of the Federal Farm Loan Act so that they will be qualified as mortgages thereunder, such mortgages, in an exact sense, are *issued* under the State laws. Incidentally, the Court of Claims ignores the word "issue". Securities which are *issued* under the Federal Farm Loan Act are the securities issued by the Land Banks and Joint Stock Land Banks, to wit, their bonds.

The above reasons, which are merely stated *seriatim* without elaboration of argument or citation of authorities which clearly support the mere statements, your petitioner submits, show clearly that the phrase "securities issued under the provisions of the Federal Farm Loan Act" does not comprehend farmers' first mortgages and, therefore, the indebtedness of Joint Stock Land Banks evidenced by their bonds, even if it may be said to be incurred for the purpose of purchasing or carrying the "first mortgages", is not for the purpose of buying or purchasing "obligations or securities the interest upon which is wholly exempt from taxation, under this title"—contrary to the opinion of the Court of Claims on which its judgment was predicated.

Incidentally, the United States urged an alternative construction of the phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title", to wit, that the exemption need not necessarily be found in Section 213 (b) (4) of the Income Tax Law but comprehends the exemption granted to "first mortgages" under Section 26 of the Federal Farm Loan Act. In other words, that "exempt from taxation under this title" meant exempt from the tax imposed by this title. This contention, apparently, the Court of Claims thought it unnecessary to consider, so there is no occasion, at this juncture, for the petitioner to discuss in detail this alternative contention.

In construing the statutes at issue, it is submitted, the defendant, treating the interest deduction exception clause and the exemption section as a series of unrelated words and applying random definitions to such words, sets up alternative constructions and urges that the indebtedness at issue falls within the exception clause. In doing this the defendant, contrary to

e rules governing the interpretation of statutes levy-
g taxes, attempts to extend the meaning of the stat-
es beyond "the clear import of the language used"
ıd "to enlarge their operations so as to embrace
atters not specifically pointed out" (*Gould vs. Gould,*
5 U. S. 151, p. 153). Neither the exception clause
or sub-section (b) of the exemption section are series
unrelated words but have a definite origin and sig-
ficance as complete clauses,—which is consistent with
ıd consequent of the purpose of Congress in adopt-
g them.

The fact that the petitioner gets the benefit of the
eduction by virtue of the consolidated return provi-
ons of the Income Tax Law does not, as the Court of
laims rightly says, defeat the deduction of the inter-
t if, in fact, it is deductible. The fortuitous advan-
ges or disadvantages of consolidated returns are not
issue. The fact that the Joint Stock Land Banks
ıd no net taxable income in the particular year, aside
om the interest deduction at issue, has no pertinency
the issue unless this fact, plus the consequences un-
er the consolidated return, is reflected in Congres-
onal action and manifested in the purpose and lan-
ıage of the interest exception clause. There is no
ıch reflection or manifestation.

Furthermore, as stated by the Court of Claims, ex-
nptions to Joint Stock Land Banks in the Federal
arm Loan Act do "not indicate the purpose or intent
Congress that they should enjoy other benefits and
xemptions not given in the Act." On the other hand,
ese exemptions were given primarily not for the
nefit of the Joint Stock Land Banks but for the
nefit of the farmers, and the petitioner suggests that
view of the drastic restrictions placed on Joint Stock

Land Banks and their earnings for the benefit of the farmers, it is not to be lightly assumed that the Congress intended any additional restrictions not set forth in the Federal Farm Loan Act or that deductions permitted by the Income Tax laws should arbitrarily be denied to Joint Stock Land Banks. Petitioner asks merely for a construction of the interest exception clause as applied to the indebtedness of Joint Stock Land Banks on their bonds in contemplation of the spirit, purpose and letter of the exception clause and accepted rules for interpreting statutes levying taxes.

Second Error Assigned.

As stated above herein among the reasons for the allowance of the petition for certiorari, the interest exception clause has been declared unconstitutional insofar as it is applied to indebtedness incurred for the purchase of Municipal bonds in a case (*Nauts vs. Slayton,* 36 Fed. (2d) 145), which is now pending before this Court on a Writ of Certiorari granted April 28, 1930. It is not the purpose of the petitioner to argue this question of constitutionality herein, but merely to suggest to this Court, as it did to the Court of Claims, that if the decision in *Nauts vs. Slayton* is sound, then, on the principles of construction laid down in *National Life Insurance Co. vs. United States, supra,* the interest exception clause is not applicable to the indebtedness of Joint Stock Land Banks at issue. If the denial of interest deduction on indebtedness incurred to purchase Municipal bonds is unconstitutional as being a tax on Municipal bonds and thus beyond the power of Congress, the Congress "had no purpose to subject" instrumentalities of the United States, the farmers' "first mortgages", "to burdens

which could not be imposed upon those of a State", so the exception clause would not be applicable to indebtedness incurred by Joint Stock Land Banks to make loans to farmers. Furthermore, to burden such farmers' "first mortgages" would be contrary to the manifest general purpose of Section 26 of the Federal Farm Loan Act, which expressly disavows any purpose to tax farmers' "first mortgages" not only as to income but in any manner whatsoever.

CONCLUSION.

Because (1) this is a "class" case and presents a question of both general importance and public interest, and (2) the constitutionality of the interest deduction exception clause is now before this Court and the question herein should be considered in connection with such question of constitutionality, and (3) the errors assigned, the petitioner respectfully submits that the petition sets forth a proper case for review by this Court and that the Writ of Certiorari should be granted.

Respectfully submitted.

HAROLD V. AMBERG,
Attorney for Petitioner.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

No. 124

THE FIRST NATIONAL BANK OF CHICAGO,
A NATIONAL BANKING ASSOCIATION,
Plaintiff,

vs.

THE UNITED STATES.

PLAINTIFF'S BRIEF.

HAROLD V. AMBERG,
Attorney for Plaintiff.

DONNELLEY-WARREN PRINTING COMPANY, CHICAGO.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

No. 124.

THE FIRST NATIONAL BANK OF CHICAGO,
A NATIONAL BANKING ASSOCIATION.

vs.

THE UNITED STATES.

PLAINTIFF'S BRIEF.

This case is before this Court by virtue of an order entered June 2, 1930, by this Court, granting plaintiff's petition for a writ of certiorari to the Court of Claims of the United States.

I.

STATEMENT OF CASE.

In this suit The First National Bank of Chicago seeks to recover $9,124.70, representing an additional income tax assessed and collected as a result of the disallowance by the Government of a deduction of interest paid by the plaintiff's two affiliated Joint Stock Land Banks on their outstanding bonds in the year 1922. The single issue as to the deductibility of such interest turns primarily on the interpretation of the so-called exception clause of Section 234 (a) (2) of Title II of the Revenue Act of 1921 (the Income Tax Law of 1921). This exception clause, qualifying the general provision of said Section 234 (a) (2) which allows deduction of "all interest paid or accrued within the taxable year", denies deduction of interest paid or accrued on indebtedness of the type specified in the exception clause.

A.

STATEMENT OF FACTS.

The case was heard below on a stipulation of facts, which was adopted substantially verbatim by the Court of Claims as its Special Findings of Fact. (R. 12 *et seq*)

The essential facts, taken from the Court of Claims Special Findings of Fact, are as follows:

The First National Bank of Chicago, a national banking association, of Chicago, Illinois, on or about March 14, 1923, filed with the Collector of Internal Revenue at Chicago a consolidated corporation income and profits tax return for the calendar year 1922, which return consolidated the income of the plaintiff corporation and the following affiliated corporations:

> First Trust and Savings Bank, an Illinois corporation, Chicago, Illinois.
>
> First National Investment Company, now First-Chicago Corporation, an Illinois corporation, Chicago, Illinois.
>
> National Safe Deposit Company, an Illinois corporation, Chicago, Illinois.
>
> First-Trust Joint Stock Land Bank of Chicago, a joint stock land bank organized under the Federal Farm Loan Act of 1916, with its principal office in the City of Chicago, Illinois.
>
> First-Trust Joint Stock Land Bank of Dallas, a joint stock land bank organized under the Federal Farm Loan Act of 1916, with its principal office in the City of Dallas, Texas. (R. 13)

In computing its income in said consolidated return the plaintiff deducted the amount of $78,807.80 as being interest paid during the year 1922 on Joint Stock Land Bank bonds of the First-Trust Joint Stock Land Bank of Chicago and the First-Trust Joint Stock Land Bank of

Dallas, but said deduction was and still is denied by the Commissioner of Internal Revenue. (R. 13)

Subsequent to the filing of said consolidated return plaintiff made certain claims for refunds and credits in regard to items not at issue herein and the Commissioner of Internal Revenue, still denying and disallowing the deduction of interest paid by said Joint Stock Land Banks, redetermined the total tax liability of the plaintiff for the year 1922 and fixed it at $430,784.08,—refunding to the plaintiff $4,466.53 representing the overassessment and overpayment by the plaintiff based on such redetermination. (Rec. 14) This question of deductibility of interest paid on their bonds by said Joint Stock Land Banks is the only matter in dispute between the plaintiff and defendant in respect of plaintiff's income tax for the year 1922.

The First-Trust Joint Stock Land Bank of Chicago and the First-Trust Joint Stock Land Bank of Dallas, which were organized under the Federal Farm Loan Act of July 17, 1916, issued to and/or had outstanding in the hands of the public in the year 1922 their Joint Stock Land Bank bonds, respectively, on which interest was paid and/or accrued in the year 1922 in the aggregate sum of $78,807.80. (R. 15) Included in said amount of $78,807.80, however, is the amount of $5,810.25 in respect of certain inter-company transactions which the Commissioner of Internal Revenue, in his final determination of the taxable net income of the plaintiff for said year 1922, allowed as a deduction and which amount the plaintiff concedes is not deductible provided the interest paid by said Joint Stock Land Banks on their outstanding Joint Stock Land Bank bonds, as herein contended, is held to be a deductible item. (R. 14) The net deduction at issue, therefore, is $72,997.55, involving a tax refund, if allowed, of $9,124.70. (R. 15)

Said Joint Stock Land Bank bonds were issued and sold by said Joint Stock Land Banks, in accordance with the provisions of the Federal Farm Loan Act and the regulations thereunder, and were secured as to payment, as required by the Federal Farm Loan Act, by the deposit with the proper Farm Loan Registrars of farmers' promissory notes evidencing loans to farmers, which in turn were secured as to payment by said farmers', first mortgages on their farms, respectively. (R. 15)

Proceeds coming to the hands of said Joint Stock Land Banks from the issue of said Joint Stock Land Bank bonds were used by said Joint Stock Land Banks to make new additional loans to farmers, which new loans, made from the proceeds of said Joint Stock Land Bank bonds issued and/or outstanding in 1922, were made in each instance in consideration of the making and delivering by the borrowing farmers, respectively, of their promissory notes secured as to payment by first mortgages on their farms. (R. 15)

All of said loans, respectively, and farmers' notes and mortgages, respectively, evidencing said loans, were designed to be and were of such a nature as to comply with (1) all the terms, conditions, restrictions, limitations and requirements specified in the Federal Farm Loan Act, as requisite to qualify said loans, notes and mortgages as "First Mortgages" in contemplation of said Act,—so as to make them available as collateral security against the issue of additional Joint Stock Land Bank bonds, and (2) all terms, conditions, restrictions, limitations and requirements, statutory or otherwise, specified in the laws of the State in which the particular farm was located, to wit, the States of Illinois, Iowa, Texas and Oklahoma, respectively, as requisite to qualify said loans, notes and mortgages as valid and subsisting first mortgages in contemplation of such laws. (R. 16)

Interest received by the plaintiff on such farmers' notes and mortgages was not taxable as income to the plaintiff and was not so taxed in respect of plaintiff's return for the year 1922. (R. 16)

Each of said farmers' notes and mortgages contains an agreement providing for the repayment of the loan on the amortization plan as provided in Section 12, Second, of the Federal Farm Loan Act, and such agreement in respect of each note and/or mortgage was such that the respective note and/or mortgage was not extinguished within a period of less than thirty-three years,—except, of course, at the option of the borrower. (R. 16)

In this brief the farmer's "first mortgage note" will be referred to as the "mortgage note" and the farm mortgage (securing the payment of the mortgage note) will be referred to as the "mortgage". Whenever the term "first mortgage" is used it is meant to include and represent both the *mortgage note and the mortgage as a unit* and is used in the sense of the definition in Sec. 2 of the Federal Farm Loan Act, reading:

> "SEC. 2. That wherever the term 'first mortgage' is used in this Act it shall be held to include such classes of first liens on farm lands as shall be approved by the Federal Farm Loan Board, and the credit instruments secured thereby."

If not indicated to the contrary, the italics throughout this brief are ours.

B.

STATEMENT OF QUESTIONS.

The single issue (involving several questions) is whether the indebtedness of a Joint Stock Land Bank evidenced by its Joint Stock Land Bank bonds (the proceeds of which are used to make loans to farmers on farm mortgage security, each loan being made in consideration of the making and delivering by the respective farmer of his mortgage note secured by his farm mortgage, as contemplated and defined in the Federal Farm Loan Act) is indebtedness of the exceptional type designated in the exception clause of Sec. 234 (a) (2) of the Income Tax Law of 1921.

Said Sec. 234 (a) (2) is as follows:

> "SEC. 234 (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * * *
>
> (2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title." (See Appendix, p. 111, for citation.)

This latter clause, beginning with "except on indebtedness", is hereinafter referred to as the "interest deduction exception clause" or simply the "exception clause".

It should be observed parenthetically at this juncture that the interest received on the farmers' first mortgages is not taxable as income to the Joint Stock Land Banks. Sec. 26 of the Federal Farm Loan Act (Act of Cong. July 17, 1916, c. 245, 39 Stat. 360) makes specific provision in this respect as follows:

> "First mortgages executed to Federal land banks,

> or to Joint Stock Land Banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, Municipal and local taxation."

Reverting to the exception clause,—an initial inquiry is whether, apart from the literal wording of the exception clause, such indebtedness of a Joint Stock Land Bank falls within the spirit and intended scope of the exception clause,—in view of the Congressional purpose in adopting the exception clause.

If the issue be viewed as turning rather on the literal wording of the exception clause interpreted in the light of its intended scope, three questions present themselves.

The first question, which if answered in the negative disposes of the issue at the threshold, is whether such indebtedness of a Joint Stock Land Bank is "incurred or continued to purchase or carry" the farmers' first mortgages, or, in fact, anything whatsoever.

The second question, which in common with the third question is material only in the event the first question is answered in the affirmative, is whether the farmers' first mortgages are "obligations or securities the interest upon which is wholly exempt from taxation under this title",—to wit, Title II of the Revenue Act of 1921,—the Income Tax Law of 1921.

Sec. 213 (b) (4) of said Title II of the Revenue Act of 1921, which is hereafter sometimes referred to as the "interest exemption section" or simply the "exemption section", is as follows:

> "SEC. 213. That for the purposes of this title (except as otherwise provided in Section 233) the term 'gross income', (b) Does not include the following items, which shall be exempt from taxation under this title: (4) *Interest upon* (a) the obligations of a

State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) *securities issued under the provisions of the Federal Farm Loan Act of July* 17, 1916; or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if, and to the extent it is wholly exempt to the taxpayer from income, war profits and excess profits taxes."

The Court of Claims, withdrawing its original opinion to the effect that the interest paid by a Joint Stock Land Bank on such bonds was not within the intended scope of the exception clause, answered both the first and second questions (erroneously in each respect, it is submitted) in the affirmative, as follows:

> "We are of the opinion that the notes and first mortgages owned and held by joint-stock land banks, and used by them as collateral security for the payment of their bonds, are *securities under* the provisions of the Federal farm loan act of 1916, and that as such the interest upon them is specifically exempted from taxation under section 213 (b) (4) of the revenue act of 1921. It follows that under the provisions of section 234 (a) (2) of that act the interest paid by joint-stock land banks on their farm loan bonds, which *is indebtedness incurred, and continued to purchase and carry such securities*, comes within the exception and is not deductible from income." (R. 26)

The third question, which in common with the second question involves the meaning of the exception clause phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title", arises

out of the defendant's alternative interpretation of such phrase, viz.: that, even if the farmers' first mortgages do not fall within Sec. 213 (b) (4) (b) as "securities issued under the provisions of the Federal Farm Loan Act" and consequently are not "obligations or securities the interest upon which is wholly exempt from taxation under this title" (to wit, the Income Tax Law of 1921), such first mortgages fall within "obligations or securities • • • the interest upon which is wholly exempt from taxation under this title" by virtue of the exemption of interest thereon contained in Sec. 26 of the Federal Farm Loan Act. This question is not answered in the opinion and decision of the Court of Claims, but is considered under II C 2 (b) *infra* p. 72.

The plaintiff collaterally presented to the Court of Claims for its consideration the decision in the case of *Nauts* v. *Slayton*, 36 Fed. (2d) 145, (decided December 6, 1929), now before this Court by virtue of a Writ of Certiorari, and urged, in the light of principles of construction laid down by this Court in *National Life Insurance Co.* v. *United States*, 277 U. S. 508 (II E *infra* p. 96), that the interest deduction exception clause, aside from considerations of the intended scope or literal wording thereof, may not be applicable to such indebtedness of Joint Stock Land Banks. This contention of the plaintiff was not mentioned in the opinion and decision of the Court of Claims.

C.

ERRORS TO BE URGED.

It is submitted that the Court of Claims erred

(1) in holding that the interest paid by a Joint Stock Land Bank on such indebtedness evidenced by its bonds is within the intended scope of the interest deduction exception clause of Sec. 234 (a) (2); (Argument *infra* II A 1 p. 14; II A 2 p. 14; and II B p. 28)

(2) in rejecting the Congressional designation in respect of the purpose for which such indebtedness of a Joint Stock Land Bank is incurred, to wit, "for carrying on the business of *lending* on farm mortgage security"; (Argument *infra* II A 3 (a) p. 16, II C 1 (a) p. 35, and (b) p. 37)

(3) in holding that such indebtedness of a Joint Stock Land Bank on its bonds is incurred "to purchase or carry" farmers' first mortgages,—in contemplation of the interest deduction exception clause; (Argument *infra* II A 3 (b) p. 19, and II C 1 (c) p. 38)

(4) in holding that the farmers' mortgage notes and/or mortgages are "obligations or securities • • • the interest upon which is wholly exempt from taxation under this title" (viz.: the Income Tax Law of 1921) by virtue of the exemption contained in Sec. 213 (b) (4) (b) thereof, which exempts "interest upon" "*securities issued under the provisions of the Federal Farm Loan Act*", or, in other words, in holding that the farmers' first mortgages fall within the scope of "securities issued under the provisions of the Federal Farm Loan Act." (Argument *infra* II A 3 (d) p. 23, and II C 2 (a) p. 52)

(5) in extending the interest deduction exception clause, "by implication beyond the clear import of the language used" and enlarging "its operation so as to embrace matters not specifically pointed out"; (Argument *infra* II D p. 79)

(6) and in applying the interest deduction exception clause to such indebtedness of a Joint Stock

Land Bank evidenced by its bonds in view of the decision in respect of the constitutionality of the clause in the case of *Nauts* v. *Slayton* and the rules of construction laid down by this Court in *National Life Insurance Co.* v. *United States.* (Argument *infra* II E p. 96)

II.

ARGUMENT.

SUMMARY.

The following is a skeleton summary, with caption refferences, of the plaintiff's argument:

In view of the purpose in mind, Congress limited the interest deduction exception clause to a definitely circumscribed type of indebtedness and the Congressional intent in such respects is an essential guide in construing not only the spirit and intended scope but also the letter of the clause (A *infra* p. 14).

The indebtedness of a Joint Stock Land Bank evidenced by its bonds, issued to create a fund to make and out of which are made loans tc farmers on farm mortgage security, as contemplated in the Federal Farm Loan Act, is not, in view of the Congressional purpose in authorizing Joint Stock Land Banks as evidenced in the Federal Farm Loan Act, within the *spirit or intended scope* of the interest deduction exception clause (B *infra* p. 28).

Such indebtedness of a Joint Stock Land Bank is not within the *letter* of the interest deduction exception clause (a) in that, in the first place, the purpose of such indebtedness is not "to purchase or carry" anything whatsoever (A 3 (a) *infra* p. 16 and C 1 (a) *infra* p. 35) and, in the second place, the incidental acquisition of the farmer's mortgage note and mortgage (in connection with the mortgage loan) does not transmute the original purpose into (C 1 (b) *infra* p. 37) or involve (A 3 (b) *infra* p. 19 and C 1 (c) *infra* p. 38) a "purchase or carry" as such phrase is used in the interest deduction exception clause and, consequently, at the threshold and without reference to other sections of the Income Tax Law or the Federal Farm Loan Act,

such indebtedness is not of the type specified in the interest deduction exception clause; and (b) in that, even assuming for the argument that such indebtedness of a Joint Stock Land Bank is incurred to "purchase or carry" the farmers' first mortgages, such first mortgages are not "obligations or securities the interest upon which is wholly exempt from taxation under this title" in that, in the first place, the only conceivably applicable exemption "under this title" is that of Sec. 213 (b) (4) (b) and farmers' first mortgages do not fall within "securities issued under the provisions of the Federal Farm Loan Act" (A 3 d *infra* p. 23 and C 2 (a) *infra* p. 52) and, in the second place, the interest exemption extended under Sec. 26 of the Federal Farm Loan Act to "first mortgages executed to" Joint Stock Land Banks does not transform such first mortgages into "obligations or securities the interest upon which is wholly exempt from taxation under this title", as specified in the interest deduction exception clause of the Income Tax Law (C 2 (b) *infra* p. 72).

In view of the above a holding that such indebtedness of a Joint Stock Land Bank falls within the interest deduction exception clause requires an extension of such clause "by implication beyond the clear import of the language used" and an enlargement of "its operations so as to embrace matters not specifically pointed out", which is contrary to the rules laid down by this Court for the interpretation of statutes levying taxes (D *infra* p. 79).

Irrespective of the intended scope or letter of the interest deduction exception clause, its application to such indebtedness of Joint Stock Land Banks is seriously to be questioned in view of the decision in respect of constitutionality in the case of *Nauts* v. *Slayton* and the rules of construction laid down by this Court in *National Life Insurance Co.* v. *United States* (E *infra* p. 96).

A.

IN ADOPTING THE INTEREST DEDUCTION EXCEPTION CLAUSE CONGRESS HAD A DEFINITE PURPOSE AND IN CONTEMPLATION THEREOF FIXED A DEFINITE LIMIT TO THE SCOPE OF THIS CLAUSE. THE CONGRESSIONAL INTENT IN THESE RESPECTS IS AN ESSENTIAL GUIDE IN CONSTRUING NOT ONLY THE SPIRIT AND INTENDED SCOPE BUT ALSO THE LETTER OF THE CLAUSE.

1.

INTEREST ON BUSINESS INDEBTEDNESS HAS CONSISTENTLY BEEN DEDUCTIBLE IN DETERMINING NET INCOME UNDER FEDERAL INCOME TAX LAWS.

Beginning with the Income Tax Law of 1913, interest paid on indebtedness has been classified consistently as deductible business expense along with such items as (a) "all the ordinary and necessary expenses • • • in the maintenance and operation of its business and properties, including rentals"; (b) "all losses actually sustained and charged off within the year"; (c) "a reasonable allowance for exhaustion, wear and tear"; and (d) to a limited extent "taxes" (Appendix).

2.

THE EXCEPTION DENYING DEDUCTION OF INTEREST "ON INDEBTEDNESS INCURRED FOR THE PURCHASE OF OBLIGATIONS OR SECURITIES THE INTEREST UPON WHICH IS WHOLLY EXEMPT FROM TAXATION UNDER THIS TITLE" (IN THE 1917 AND SUBSEQUENT ACTS) WAS AIMED AT THE TAXPAYERS' PRACTICE OF BORROWING MONEY TO PURCHASE A SPECIFIED CLASS OF TAX EXEMPT SECURITIES, THEREBY GETTING THE BENEFIT OF THE EXEMPTION OF THE INTEREST RECEIVED AND THE DEDUCTION OF THE INTEREST PAID ON THE INDEBTEDNESS SO INCURRED.

In the Majority Report of the Committee on Finance of the Senate (65th Cong. 3d Session—Senate Report No.

617, December 8, 1918, at p. 6) submitted in connection with the 1918 Income Tax Law, is the following statement:

"DEDUCTIONS.

The interest deduction (sec. 214, a, 2, and sec. 234 a, 2), has been amended so as not to permit a deduction for interest on indebtedness incurred or continued to purchase or carry tax-free securities other than obligations of the United States issued after September 24, 1917. *This limitation is substantially the same as the one contained in the present law.* The provisions of the House Bill which allow a deduction for interest on all indebtedness permits the taxpayer to make loans *for purchases of* wholly exempt securities and then deduct the interest paid on such loans from his otherwise taxable income, thereby reducing his tax. *The limitation suggested above would operate to discourage this practice* except in the case of the latter issues of Liberty Bonds."

In other words the intent of Congress was to accomplish a definite purpose, that is, to discourage a practice adopted by taxpayers to reduce their taxes.

The immediate purpose of the exception to interest deduction was to forestall deliberate tax avoidance in view of the high surtax rate and the ever increasing amount of tax exempt securities *readily purchasable in the open market.* The Secretary of the Treasury, in his annual report to the Congress dated December 6, 1922, recommended that the highest surtax be reduced from fifty per cent to twenty-five per cent. He also stated that fully tax exempt securities then aggregated about $11,000,000,000 and that they were increasing at about the rate of $1,000,000,000 a year. (Preface, "Income Tax Procedure," *infra.*)

Robert H. Montgomery in his book "Income Tax Procedure, 1923" in reference to the interest deduction exception clause says, at p. 869:

"The restriction on the deduction is sound. It

was made imperative by the establishment of very high income tax rates. So long as the rates of the tax were low, there was no appreciable inducement to a taxpayer to borrow money with which to buy tax-exempt securities. Under very high surtax rates the situation changed. Without this restriction taxpayers subject to high rates would find it profitable *to buy tax-exempt securities on a large scale with borrowed money*, using the interest on such borrowings as a deduction from taxable income from other sources."

3.

BY ITS EXPRESS LANGUAGE THE EXCEPTION CLAUSE DENIES DEDUCTION OF INTEREST IN RESPECT ONLY OF INDEBTEDNESS INCURRED OR CONTINUED WITH (A) THE PURPOSE (AND SO USED) (B) TO PURCHASE OR CARRY (C) NOT TAX EXEMPT SECURITIES OR OBLIGATIONS IN GENERAL, BUT (D) A SPECIFIED CLASS OF "OBLIGATIONS OR SECURITIES," TO WIT, THOSE THE "INTEREST UPON WHICH IS WHOLLY EXEMPT FROM TAXATION UNDER THIS TITLE,"—CONGRESS HAVING, IN SECTION 213 (B) (4), SPECIFIED OBLIGATIONS OR SECURITIES THE INTEREST UPON WHICH IS "EXEMPT FROM TAXATION UNDER THIS TITLE."

Congress, having in mind a specific purpose, definitely limited the scope of the interest deduction exception clause to a *definitely circumscribed type of indebtedness.*

(a)

PURPOSE OF THE INDEBTEDNESS.

In the first place, the indebtedness must have been incurred or continued with the *purpose* to purchase or carry the specified exempt securities.

As an illustration, in Solicitor's Recommendation 5128, IV-2, C. B. 156, it is stated:

"Interest paid by the taxpayer on amounts credited to its customers for products sold on consign-

ment basis, such amounts being left on deposit with the taxpayer and used at various times to purchase municipal and State bonds, is not interest paid on indebtedness incurred to purchase securities, the interest upon which is exempt from tax.

It is the opinion of this office, (Solicitor of Internal Revenue), that interest paid on amounts credited to the taxpayer's clients is interest paid on indebtedness within the meaning of Section 234 (a) 2 of the Revenue Acts of 1918 and 1921 (I. T. 2028, C. B. III-1, 296), and is an allowable deduction from gross income. It can not be said that indebtedness incurred by reason of such credits is incurred to purchase or carry tax-exempt securities. In this respect the taxpayer's business is in the nature of banking, and in the case of a bank indebtedness incurred by reason of deposits which are invested in tax-exempt securities is not incurred to purchase or carry such securities.

It is, therefore, recommended that the protest of the taxpayer in this case be sustained and the action of the Income Tax Unit be modified in accordance with the above opinion."

Incidentally, this ruling indicates clearly that the mere casual coincidence of exemption of interest on securities held and deduction of interest on indebtedness incurred does not stigmatize the indebtedness as "indebtedness incurred to purchase or carry securities or obligations the interest upon which is wholly exempt from taxation under this title".

Again in Office Decision of the Income Tax Unit, 1213, I-1, C. B. 132, construing the exception clause of the Revenue Act of 1921 (now at issue), it is said:

"The interest paid on a loan which a taxpayer was obliged to continue in order to cover losses sustained on the sale of Liberty Bonds is an allowable deduction from gross income under the provisions of Section 234 (a) (2) of the Revenue Act of 1921. Likewise, *interest paid on a loan made to pay city taxes, Liberty bonds being deposited as security* for the loan, *is deductible* for income tax purposes."

Here is manifested a very strict attitude against extension of the exception clause. It should be noted that such was not a *carry* of the Liberty Bonds. The fact that the loan was made, with Liberty Bonds merely as security, to pay city taxes, took it out of the clause. The purpose of the indebtedness is controlling. Here again is a clear indication that the mere casual coincidence of exemption of interest on securities held and deduction of interest on indebtedness incurred, does not stigmatize the indebtedness as "indebtedness incurred to purchase or carry securities or obligations the interest upon which is wholly exempt from taxation under this title".

Again (Income Tax Procedure, 1923, Montgomery, at p. 687) we find the following:

> "It is the ruling of this office that a bank doing a commercial business and receiving deposits upon which it pays interest is entitled to deduct from its gross income shown upon its annual tax return the full amount of interest paid to its depositors. The payment of such interest is one of the ordinary and necessary expenses in the carrying on of its business. Although the deposits constitute indebtedness of the bank, such indebtedness was not incurred and is not continued for the purpose of purchasing or carrying obligations, even though the deposits are invested in bonds or other obligations the interest upon which is wholly exempt from income and excess profits tax. (Letter to Lybrand, Ross Bros. & Montgomery, signed by Commissioner Roper, June 24, 1919.)"

Here again the casual coincidence of exemption of interest on securities held and deduction of interest on indebtedness incurred, does not stigmatize the indebtedness as "indebtedness incurred to purchase or carry securities or obligations the interest upon which is wholly exempt from taxation under this title".

The rulings and decisions cited above indicate clearly

that the occasion (purpose) of the incurring or continuing of the indebtedness may take the indebtedness out of the exception clause, irrespective of the use of the proceeds of the indebtedness "to purchase or carry" any of the obligations specified in the exception clause. The exception clause embraces only such indebtedness as has two qualities, to wit, one, of being incurred or continued with an immediate and express purpose "to purchase or carry" one of the specified obligations and, second, its proceeds must be used "to purchase or carry" one of the specified obligations. Of course, if the proceeds are not used "to purchase or carry" one of the specified obligations the mere purpose of the incurring or continuing of the indebtedness is of no consequence.

(b).

"TO PURCHASE OR CARRY."

It seems unnecessary to discuss at length the definition of the word "purchase" as used in the exception clause. Considering the purpose, subject matter and context of the clause, "purchase" obviously means "buy for money or money equivalent" with possibly but not necessarily an inference of simultaneous cash payment out of the proceeds of the borrowing.

The true meaning of the word "carry" as used in the exception clause is not so immediately obvious. The initial inquiry is whether the word "carry" is supplemental to the word "purchase", or whether it introduces a new act entirely unassociated with "purchase", and, if so, what act.

As we have seen, the Income Tax Unit has (at least heretofore) apparently construed and restricted the exception clause to indebtedness having some relation to the purchase of the specified securities. It clearly has

not adopted any general definition of the word "carry", —unrelated to a purchase. For example, in Office Decision 1213 (*supra*, p. 17) it was held that "interest paid on a loan which a taxpayer was obliged to continue in order to cover losses sustained on a *sale* of Liberty bonds is an allowable deduction under the exception clause. Furthermore, interest paid on a loan made *to pay city taxes*, Liberty bonds being deposited as security, is likewise deductible." In the latter case, although the indebtedness was incurred clearly "to bear the charges or burden of holding" the Liberty bonds (as distinguished from selling them to raise the tax money) the indebtedness was not incurred to "carry" the exempt Liberty bonds. In other words, the indebtedness was incurred and used *to pay city taxes* and was, therefore, not incurred to "purchase" the Liberty bonds and it was not incurred "to carry" the Liberty bonds because the indebtedness has no relation to the purchase (past or present) of the Liberty bonds or the payment therefor.

The soundness of this construction is clearly borne out by the history of the language of the phrase "to purchase or carry". The original interest deduction exception clause in the 1917 Act (See Appendix, Sec. 1207) reads "except on indebtedness *incurred for the purchase* of obligations, etc.". This language was extended in the 1918 Act (See Appendix, Sec. 234 (a) (2)) to read "except on indebtedness *incurred or continued to purchase or carry* obligations, etc.". Apparently the words "continued" and "carry" were added to make clear the full intent of the original clause ("indebtedness incurred for the purchase") so as to eliminate captious argument that indebtedness *continued* to *"purchase"* was not indebtedness *incurred* to "purchase" or that indebtedness incurred to *"carry"* a purchase was not indebtedness incurred to *purchase*. In other words, even though the

indebtedness is incurred six months before the actual purchase, and even for another purpose, it is, if *continued* in order to purchase, *incurred for the purchase*, or, on the other hand, if the particular security is purchased first and then indebtedness is subsequently incurred or continued to pay the price promised at the time of purchase, *i. e.*, to *carry* the purchase, such is an *"indebtedness for the purchase"*. To put it another way, the word "continued" after "incurred" and the word "carry" after "purchase" have a parenthetical aspect and relate back to the preceding words, respectively, with a view of making clear the Congressional intent that the order in time of the incurring of the indebtedness, on one hand, and the purchase of the securities, on the other hand, is inconsequential,—the essential feature being that the proceeds of the indebtedness are used to pay the price of *a "purchase"*.

This apparently obvious purpose of the addition of the words *"continued"* and *"carry"* in the 1918 Act is abundantly confirmed in the Finance Committee Report in respect of the 1918 Act (quoted above at page 15) to the effect that *"this limitation is substantially the same as the one contained in the present law"*, to wit, the 1917 Act, which referred only to "purchase".

Again, it will be noted that the Senate Committee on Finance, in reporting the 1918 law, which for the first time added the words "to carry", still refers to the making of loans "for purchases of" tax exempt securities (*supra*, p. 15).

Furthermore, in the financial world one is said to carry a security when he borrows money and uses it to pay the purchase price of the security purchased by him,—in other words, he borrows to "carry" his purchase. The word "carry" is not a word of art and has no accepted legal significance, so it is not reasonably to

be assumed that Congress, in view of the context, used "carry" in any different or broader sense than it is used in fiancial transactions of the kind under consideration.

Thus it appears that previous rulings of the Income Tax Unit, the legislative history of the language of the phrase "to purchase or carry", and the sense of "to carry" in financial transactions of the kind under consideration, are in agreement to the effect that the word "carry" in the phrase "to purchase or carry" merely supplementally defines the word "purchase" and, further, to the effect that a "carry" within the exception clause must be predicated on and presupposes a "purchase" of securities of the type specified in the exception clause.

In fact, considering the context, it is difficult to conjure up any situation or transaction which would give to the word "carry" any significance disassociated completely from the purchase of securities or the payment of the purchase price in respect of a purchase of such securities. Considering the purpose and context of the exception clause, to what purpose would a borrower incur indebtedness other than in some connection with a purchase of such securities?

(c)

NOT TAX EXEMPT SECURITIES OR OBLIGATIONS IN GENERAL.

The denial of interest deduction was not aimed at the purchase of any and all securities tax exempt as to income.

In the Appeal of *Greenville Textile Supply Co.*, Dec. 66, 1 B. T. A. 152, subsequently acquiesced in by the

Commissioner of Internal Revenue, it was held on appeal of the taxpayer that:

> "Interest paid or accrued by a corporation within the taxable year on its indebtedness incurred or continued to purchase or carry stock in a domestic corporation, where the dividends are exempt from tax, is an allowable deduction, since the stock does not come within the terms 'obligations or securities, the interest upon which is exempt from taxation'. In order to disallow the deduction, it is not only necessary to construe the word 'securities' to mean 'stock' but to construe the word 'interest' to mean 'dividends.'"

It will be noted that there is a suggestion by the Board of Tax Appeals that the word "securities" has a limited application in contemplation of the full context of the exception clause rather than an independent meaning as an isolated word.

Congress, obviously, was not attempting to circumvent every coincidence of interest deduction and income exemption but aimed to defeat interest deduction in respect of indebtedness incurred to purchase or carry only a specific class of securities or obligations.

(d)

A SPECIFIED CLASS OF "OBLIGATIONS OR SECURITIES".

The denial of interest deduction was aimed against indebtedness incurred to purchase or carry a specified class of securities, to wit, "obligations or securities the interest upon which is wholly exempt from taxation under this title",—not against indebtedness incurred to purchase or carry "securities", or "obligations", or "interest bearing obligations", or "tax exempt securities or obligations", or "tax exempt interest bearing obligations" or "securities or obligations in whole or in part exempt from income tax", but, specifically, against

indebtedness incurred to purchase or carry *"obligations or securities the interest upon which is wholly exempt from taxation under this title"*.

Any proper interpretation of the exception clause requires, therefore, that the phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title" must be construed as a unit and not as a series of unassociated words.

Section 213 (b) (4) of Title II of the Revenue Act of 1921 (see Appendix) expressly designates the obligations or securities the interest upon which is "exempt from taxation under this title" (incidentally, indicating where the exemption is only partial) as follows:

> "(a) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916; or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income, war profits and excess profits taxes."

Furthermore, Congress, in drafting the original exception clause (Act of 1917) borrowed the words "obligations", "or", "securities", and "interest upon" from the exemption section. When the exception clause was formulated, the interest exemption section exempted only *"obligations"* and *"securities"*, and the exception clause adopted the verbiage of the exemption section and used the two words in the very order they appear in the

exemption section, to wit, obligations first, and securities second.

The obligations or securities designated in the interest exemption section (Section 213 (b) (4)) are obligations of the Government, such as United States Treasury Bonds, Treasury Notes, Treasury (war) Savings Certificates, Liberty Bond Issues, Victory Liberty Loan Convertible Notes, also obligations of States, Territories and political subdivisions thereof, such as counties, cities and special assessment districts; also obligations of the District of Columbia; also bonds issued by the War Finance Corporation, a Federal agency, and "securities issued under the provisions of the Federal Farm Loan Act". The argument under C. 2, *infra*, p. 52, will, it is submitted, clearly disclose that the latter are the bonds issued by the Federal Land Banks and Federal Joint Stock Land Banks, created under the Federal Farm Loan Act,—said bonds (in contrast to farmers' first mortgages) being of the same category as obligations and securities issued by the United States, States, counties, cities and the War Finance Corporation, and being also in the class of obligations and securities contemplated and specified in the interest deduction exception clause,—being (again in contrast to farmers' first mortgages) available in the market for purchase by taxpayers seeking to get the benefit of interest deduction and interest exemption, against which Congress adopted the interest deduction exception clause.

4.

THE DEFINITE PURPOSE AND CONSEQUENT LIMITED SCOPE OF THE EXCEPTION CLAUSE ARE ESSENTIAL GUIDES IN CONSTRUING NOT ONLY THE SPIRIT AND INTENDED SCOPE BUT ALSO THE LETTER OF THE CLAUSE.

From the previous discussion under this heading it is apparent that in adopting the interest deduction exception clause Congress had a definite purpose. That purpose was not to deny deduction of interest on indebtedness connected generally and indefinitely with the *acquisition or holding of tax-exempt securities* but was a definite and limited purpose to deny interest deduction on indebtedness connected directly with the *buying and paying for a specified class of obligations or securities, i. e.,* it is submitted, those designated in the interest exemption section (Section 213 (b) (4)).

This purpose and the limited scope of the exception clause, in contemplation of that purpose, are essential guides in construing not only the spirit and intended scope but also the letter of the clause.

As said by this Court in *Holy Trinity Church* v. *United States,* 143 U. S. 457, at p. 463:

> "Again, another guide to the meaning of the statute is found in the evil which it is designed to remedy; and for this the Court properly looks at contemporaneous events, the situation as it existed, and as it was pressed upon the attention of the legislative body."

And, further, as said by this Court in *Heydenfeld* v. *Daney, Gold,* etc., 93 U. S. 634, at p. 638:

> "It is true that there are words of present grant in this law; but, in construing it, we are not to look at any single phrase in it, but to its whole scope, in order to arrive at the intention of the makers of it. * * * There is no better way of discovering its true meaning, when expressions in it are ren-

dered ambiguous by their connection with other clauses, than by considering the necessity for it, and the causes which induced its enactment. With these rules as our guide, it is not difficult, we think, to give a true construction to the law under consideration."

Again, as said by this Court in *United States* v. *Union Pacific R. R. Co.*, 91 U. S. 72, at p. 79:

"But courts, in construing a statute, may with propriety recur to the history of the times when it was passed; and this is frequently necessary, in order to ascertain the reason as well as the meaning of particular provisions in it."

B.

THE INDEBTEDNESS OF A JOINT STOCK LAND BANK EVIDENCED BY ITS BONDS, ISSUED TO CREATE A FUND TO MAKE, AND OUT OF WHICH ARE MADE, LOANS TO FARMERS ON FARM MORTGAGE SECURITY IN CONTEMPLATION OF THE FEDERAL FARM LOAN ACT, IS NOT WITHIN THE SPIRIT OR THE INTENDED SCOPE OF THE INTEREST DEDUCTION EXCEPTION CLAUSE.

The distinguishing features of this Joint Stock Land Bank indebtedness will appear from a brief consideration of the origin of Joint Stock Land Banks and of what purpose they were to and do serve.

The Report of the Joint Committee on Rural Credits (64th Congress, 1st Session, House of Representatives, Document No. 494, submitted January 3, 1916), together with a draft of a proposed bill to provide a system of land mortgage credits in the United States under Federal supervision, tells the story as follows:

> "NECESSITY FOR FARM CAPITAL.
>
> The successful farmer becomes more of a business man each year. He must use more machinery, buy more fertilizer, and sow better seed. He must erect better buildings, raise better stock, and grow better crops. He must store his produce in order to sell in a high market. He must pay cash in order to buy cheap. If he wishes to keep his children on the farm, he must make his home attractive. All of this costs money. He must have ready cash."

The report then relates the difficulty a farmer has in securing long-time credits at reasonable interest rates without frequent "substantial renewal fees"; that commercial banks must keep their deposits in short-time loans and are not suited to farmers' long-term needs; that the commercial bank has a valid claim to demand deposits; that this leaves available only savings or time

deposits and money seeking long-term investment; that time deposits are not available for long-term mortgages but there is an abundant supply of money, such as *savings, estate* and *trust funds,* etc., seeking long-term investment under safe conditions, and adds on page 7:

> "INVESTOR AND FARMER BROUGHT TOGETHER FOR MUTUAL PROFIT.
>
> Here we discover the funds that should be made available to the farmers on long-term mortgage. *We may picture the owners of this vast wealth grouped on one side of a river, the farmers desiring loans grouped on the other side.* It is evident that each has what the other wants. We are asked to furnish *the bridge* which shall bring them in touch, or rather to grant a franchise to those who will build the bridge if we will construct the approaches. Such we conceive to be a proper function of the Government."

The report goes on to state the safeguards which shall be thrown around farm loan bonds so as to make them attractive as long-term investments at reasonably low rates of interest; sets forth the machinery for the twelve land banks, relates that farm loan bonds issued by said banks shall be secured by farmers' mortgages; that the land banks are not permitted to charge the farmer borrowers in excess of 1 per cent more of interest than the banks pay out on their bonds; that said mortgage loans to farmers are restricted to certain purposes and must be on farms appraised under Federal supervision, etc.

On page 11, under the heading of "Interest Rates to Farmers", the Committee reports:

> "Present interest rates to farmers are so confused with commissions, fees, and charges of various sorts that it is difficult to ascertain the total cost of money on farm mortgages. Dr. C. W. Thompson, specialist in charge of rural organization in the Department of Agriculture, reports that the average rate varies from 5.3 per cent in New Hampshire to

9 per cent and even 10 per cent in certain Southern and Western States, including commissions. As this is the average rate, there must be individual cases running much higher. Testimony before the joint sub-committees of the Senate and House Committees on Banking and Currency in 1914 gave the maximum rate as high as 25 per cent, including commissions and charges.

It is readily seen that a rate as low as 5 per cent, 5½ per cent, or even 6 per cent would be of great benefit to farmers in most sections of the United States."

The report continues with a recital of how advantageous long-term mortgages would be to the farmers; that the amortization payments over a long period of time relieves pressure in time of financial stress.

On page 14 of the report, the Committee discusses Joint Stock Land Banks in the following language:

"In some localities where land values are settled and farmers are accustomed to borrow from mortgage banks it is quite possible that farmers will prefer to obtain mortgage loans from a joint-stock bank operating under a Federal charter, with Federal restrictions and supervision.

Some farmers, moreover, may object to the association with their neighbors in co-operative undertakings; they may not like the publicity and scrutiny that co-operation entails; they may not be able or willing to subscribe 5 per cent of the face of the desired loan to the stock of the local association. Moreover, associations may start slowly in some States, leaving a wide field unoccupied for years.

Provision is therefore made (sec. 19) for the organization of joint stock land banks of not less than $250,000 capital, to be privately subscribed. Their operations will be confined to a single State, and *they will be permitted to make loans, and to issue farm loan bonds under the supervision of the farm loan board.* Their stockholders will assume double liability. Their capital will be readily available from the outset, and they will thus have certain advantages over co-operative banks in getting their

money out on loans. In order, therefore, to equalize to some extent the earning power of the two classes of banks, they are limited in the issue of bonds to fifteen times their capital and surplus. The co-operative banks may issue bonds to the amount of twenty times their capital and surplus.

Joint-stock land banks are not permitted to engage in any business but making farm mortgage loans and issuing bonds. In States with populations exceeding two millions of people, their capital stock must be not less than $500,000. Their bonds are called joint-stock bonds, and must be in such form as to be readily distinguished from bonds issued by Federal (co-operative) land banks. They are given a free hand as to interest rates on loans and bonds, except that the margin for expense and profit must not exceed 1 per cent a year on the principal of outstanding loans. (sec. 19.)

Provision is thus made for the existence of the three types of mortgage loans. They will be competitors in *granting loans* and in *selling bonds*, but they will all be under strict Government supervision. Each type, in order to survive, must prove its usefulness. Your subcommittee feels that there is a field for all three."

So much for the Committee Report. The Federal Farm Loan Act of 1916 was ultimately passed to serve all these fundamental purposes, and Joint Stock Land Banks were authorized along the lines set forth and for the purposes set forth. It should be noted, however, that in the Act as finally passed, a Joint Stock Land Bank was also given power to engage in operations incidental to carrying on its business of lending to farmers, but was not given "free hand as to interest rates on loans and bonds", but on the contrary a maximum interest rate of 6 per cent on farmers' notes was stipulated with the proviso that within even that restriction the interest rate charged the farmers should not be in excess of 1 per cent over the interest rate of the last issue of the Joint Stock Land Bank bonds issued by the bank. Furthermore, as an essential part of the scheme to get

the loans to the farmers at a low interest rate, Congress expressly, in Sec. 26 of the Federal Farm Loan Act, exempted from income tax the interest received by Joint Stock Land Banks on the farmers' mortgage notes and the interest received by the holder of Joint Stock Land Bank bonds,—the United States absorbing the income tax loss in both instances.

The creation of Joint Stock Land Banks, it was contemplated, would invite private capital available for long-term investment into the farm mortgage field. The original capital of such a bank was to be invested in farm mortgages at a relatively low interest rate for such long-time loans and without any other charge to the farmer, except the expense of verifying title, etc. The farmers' notes and mortgages evidencing such loans (incidentally referred to as "credit instruments" in the Farm Loan Act) were in turn to be pledged with the Federal Registrar as security for the payment of long-term bonds to be issued and sold to the public by the Joint Stock Land Bank. The proceeds of the sale of these bonds, being available for long-term investments, were to be used to *make additional loans to farmers.* The additional notes and mortgages evidencing such additional loans to the farmers were to be used, by way of pledge, as security for the issuance and sale of additional bonds to the public, and the proceeds of said additional bonds were to be used for additional loans to the farmers, etc., etc.

As stated by the Joint Committee in its Report:

> *"Joint Stock Land banks are not permitted to engage in any business but making farm mortgage loans and issuing bonds."*

or as stated by the Attorney General, in discussing the constitutionality of the Farm Loan Act, (31 Op. Atty. Gen., 105):

> "I do not deem it necessary to analyze the Act in

detail. *It is sufficient to say that the mortgages and farm loan bonds are of the very essence of the system created by it.* The original capital of the Federal land banks is to be *loaned,* through the agency of national farm loan associations, to bona fide cultivators of the soil *on first mortgages on farm lands.* When a sufficient amount in such mortgages has accumulated, they are to be turned over to a 'registrar' appointed by the Farm Loan Board, and, with the approval of that board, *farm loan bonds are issued by the land bank and sold.* With the proceeds *further loans* are made on mortgages, which mortgages in their turn become the basis for an *additional issue of bonds. This continuous flow and reflow of mortgages and bonds constitutes the prime functio.i of the whole system.*"

Such was the scheme as contemplated in the Farm Loan Act, and such is the practical working. The Joint Stock Land Bank indebtedness on which interest deduction is claimed herein, is evidenced by bonds having a maturity of thirty years. This is obviously not a temporary borrowing to avoid taxes. The farmers' mortgage notes, respectively, are amortized over a period of not less than thirty-three years (R. 16) and do not bear an interest rate higher than the legal limit of six per cent.

It is submitted that in borrowing money on its bonds to create a fund to make, and out of which are made, loans to farmers, as contemplated by Congress in the Federal Farm Loan Act, a Joint Stock Land Bank is not indulging in the "practice" which the Congress desired to "discourage" when it denied interest deduction in respect of certain indebtedness. In other words, the bank is not borrowing to take advantage of a "practice" which avoided income taxation. On the contrary, in borrowing on its bonds to create a fund to loan money to farmers it is engaging in the primary business contemplated by the Congress. It is also incurring an indebtedness in the ordinary course of business as a busi-

ness expense and in full conformity with the single purpose of its creation. In fact, the first and only specific powers specified in the Charters of the Joint Stock Land Banks (see Appendix) are "to loan money, to issue its bonds".

Clearly, therefore, such indebtedness of a Joint Stock Land Bank is absolutely foreign to the indebtedness refered to in the interest deduction exception clause, and such borrowing of a Joint Stock Land Bank is not within the spirit or the intended scope of the interest deduction exception clause.

The defendant, ignoring considerations in respect of the spirit or intended scope of the interest deduction exception clause, urges that said indebtedness of a Joint Stock Land Bank is within the literal meaning of the interest deduction exception clause. The plaintiff is not unmindful that this Court has rejected literal interpretations because they were not within the intended scope of the statute. For example, in *Holy Trinity Church* v. *United States,* 143 U. S. 457, this Court said, at page 459:

> "It is a familiar rule, that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers" etc.

and again in *Heydenfeld* v. *Daney, Gold etc.,* 93 U. S. 634, at page 638:

> "If a literal interpretation of any part of it would operate unjustly, or lead to absurd results, or be *contrary to the evident meaning of the act taken as a whole,* it should be rejected."

The plaintiff in this case, however, is not confined to a reliance on the above rules of statutory construction because it confidently submits that such indebtedness of a Joint Stock Land Bank is not within even the *letter* of the interest deduction exception clause.

C.

THE INDEBTEDNESS OF A JOINT STOCK LAND BANK EVIDENCED BY ITS BONDS, ISSUED TO CREATE A FUND TO MAKE, AND OUT OF WHICH ARE MADE, LOANS TO FARMERS ON FARM MORTGAGE SECURITY, AS CONTEMPLATED IN THE FEDERAL FARM LOAN ACT, IS NOT WITHIN THE LETTER OF THE INTEREST DEDUCTION EXCEPTION CLAUSE, IN THAT (1) IT IS NOT "INDEBTEDNESS INCURRED OR CONTINUED TO PURCHASE OR CARRY" AND (2) FARMERS' FIRST MORTGAGES, IN ANY EVENT, ARE NOT "OBLIGATIONS OR SECURITIES THE INTEREST UPON WHICH IS WHOLLY EXEMPT FROM TAXATION UNDER THIS TITLE".

1.

SUCH INDEBTEDNESS IS NOT "INDEBTEDNESS INCURRED OR CONTINUED TO PURCHASE OR CARRY" IN THAT—

(a)

THE IMMEDIATE AND EXPRESS PURPOSE OF SUCH INDEBTEDNESS, AS WELL AS THE USE TO WHICH THE PROCEEDS THEREOF ARE PUT, IS SIMPLY TO MAKE LOANS TO FARMERS ON MORTGAGE SECURITY AND, CONVERSELY, IS NOT TO "PURCHASE OR CARRY" ANYTHING WHATSOEVER.

As we have seen (*supra*, pp. 16-19), the immediate and express *purpose* for which an indebtedness is incurred, to wit, whether it is to "purchase or carry" the specified obligations or securities, has a fundamental bearing on whether such indebtedness falls within the meaning of the interest deduction exception clause. The immediate and express purpose of a Joint Stock Land Bank in incurring such indebtedness by borrowing on its bonds is simply to create a fund which may be loaned to farmers on farm mortgage security in consideration in each case of the making and delivery by the borrowing farmer of his first mortgage (note and mortgage). Congress itself, in the Federal Farm Loan

Act (Section 16), expressed this purpose in the following language:

> "That corporations, to be known as joint stock land banks, for carrying on the business *of lending* on farm mortgage security and *issuing farm loan bonds,* may be formed by any number of natural persons not less than ten."

The Joint Congressional Committee, in reporting the Federal Farm Loan Act to Congress (*supra,* p. 30), expressed the purpose as follows:

> "They will be permitted *to make loans,* and to issue farm loan bonds under the supervision of the farm loan board."

The Attorney General (*supra,* p. 33) expressed the purpose in the following language:

> "With the proceeds (of farm loan bonds issued and sold by the banks) *further loans* are made on mortgages."

The charters of the said two Joint Stock Land Banks, respectively (see Appendix), read "said bank is hereby granted authority and power *to loan money,* issue its bonds, and to do all other things etc.".

Furthermore, the inclusion of "loan" in the title "Federal Farm Loan Act" and also the title "Federal Farm Loan Board" confirms the Congressional view of the purpose and nature of the primary function of the Federal Land Banks and Joint Stock Land Banks in respect of their first mortgage operations. The Federal Farm Loan Act is replete with words and phrases which proclaim that such indebtedness is incurred and in fact authorized for the fundamental purpose of making loans.

It is submitted, therefore, that the purpose of such indebtedness as expressed by Congress in the Farm Loan Act, by the Joint Congressional Committee, by the Attorney General and the banks' charters should

be accepted as conclusive of the Congressional intent in determining whether the purpose of such indebtedness falls within the purpose of the indebtedness specified, immediately subsequent in point of time, by Congress in the interest deduction exception clause. If so accepted, such indebtedness of a Joint Stock Land Bank is not within the purpose expressed in the interest deduction exception clause and, therefore, is at the very threshold not within the letter of the interest deduction exception clause.

A Joint Stock Land Bank, in making such loans, obviously and concededly uses the proceeds of such indebtedness in conformity with the purpose for which it incurred it. In respect of both purpose and use of proceeds thereof, such indebtedness of a Joint Stock Land Bank does not fall within "indebtedness incurred or continued to purchase or carry".

(b)

THE ACQUISITION OF THE FARMER'S FIRST MORTGAGE IS MERELY INCIDENTAL TO THE MAKING OF THE LOAN AND DOES NOT TRANSMUTE THE PURPOSE OF SUCH INDEBTEDNESS OR THE USE OF THE PROCEEDS THEREOF INTO THAT OF "PURCHASE OR CARRY".

It is true that in making a loan to a farmer a Joint Stock Land Bank incidentally acquires, as contemplated in the Federal Farm Loan Act, a first mortgage on the borrowing farmer's farm. It is also true that a Joint Stock Land Bank (to the extent that proceeds of bonds are loaned to farmers) incurs such indebtedness on its bonds and uses the proceeds thereof with a view to the incidental acquisition of the farmer's first mortgage. These circumstances, however, it is submitted, do not transform the purpose of the indebtedness or the use of the proceeds into a purpose or use of proceeds "to

purchase or carry". The purpose and use of the proceeds, as indicated by the Congress itself, remains as before, to wit, to make loans to farmers on mortgage security.

(c)

EVEN THE INCIDENTAL ACQUISITION OF THE FARMER'S FIRST MORTGAGE DOES NOT INVOLVE A "PURCHASE OR CARRY" AS SUCH WORDS ARE USED IN THE INTEREST DEDUCTION EXCEPTION CLAUSE.

Assuming that the purpose of such indebtedness and the use of the proceeds thereof may be said to be to acquire the farmer's first mortgage, such acquisition does not involve a "purchase or carry" of the first mortgage within the clear and plain meaning of the words "purchase or carry" as such words were deliberately used by Congress in building up the phrase "indebtedness incurred or continued to purchase or carry".

By way of preliminary comment, plaintiff submits that the issue herein turns primarily on whether the indebtedness at issue is of the type of "indebtedness" which Congress identified by the phrase "indebtedness incurred or continued to purchase or carry" specified obligations; that such phrase must be considered as a unit; and that the identification of the "indebtedness" is not expedited or proved by considering the phrase "incurred or continued" as divorced from the phrase "to purchase or carry" and vice versa, or by considering the word "continued" as divorced from "incurred" or the word "carry" as divorced from "purchase",—particularly when there is clear manifestation of Congressional intent that the phrase has a meaning as a unit. Treating the phrase "incurred or continued to purchase or carry" as a group of isolated words (attributing unrelated meaning and significance to each) not only makes

any identification difficult but also entails considerable discussion to show that the words, even if considered independently, do not fit together and into the Congressional intent unless they are given the meaning and significance which the context of the whole phrase would originally attribute to them.

The defendant proposed below and the Court of Claims, disclaiming any intent to apply technical meanings different from that in which the word is "ordinarily used", adopted (R. 21, 22) numerous unrelated definitions and synonyms of the word purchase and the word carry, culled at random to illustrate the respective meanings of these words in general or in the various branches of the law (including statutes). Furthermore, the Court of Claims (R. 22), relying *en masse* on these numerous unrelated definitions and synonyms and without specification, states that "the words *purchase* or *carry* in our opinion, are apt words and characterize *precisely* the *acquisition* of and the *holding* of farmers' notes and mortgages by joint-stock land banks". This statement involves in its double aspect the meaning of "purchase or carry" and the nature of the transaction involved in a Joint Stock Land Bank's acquisition of a farmer's first mortgage. Passing the latter for the moment, let us note what meaning the Court of Claims attributed to the phrase "to purchase or carry".

As to the word "purchase",—it is submitted that, with the exception of one definition, the definitions and synonyms adopted by the Court of Claims (R. 21) are foreign to and do not reflect in any precise or exclusive sense the meaning of the word "purchase" as used in the exception clause. Technical definitions such as

> "Law: Technically, to acquire (real estate) by any means whatever other than descent or inheritance."

and the broad legal definition:

> "The term 'purchase' in its general signification, and which is the legal sense of it, includes all modes of acquiring property except by descent, and it embraces a devise." *McCartee* v. *Orphans' Asylum*, (N. Y.) 9 Cow. 437.

and the definitions in respect of special branches of the law, such as that of negotiable instruments, to wit:

> "The payee of a note is the purchaser thereof, if he advances money or otherwise parts with valuable consideration therefor." 8 C. J. 468, 469, 470.

and the definition:

> "Law: (1) To acquire (property) by one's own act or agreement, as distinguished from the act or mere operation of law."

and the synonyms:

> "Acquire; bargain for; barter for; get; obtain; procure; secure."

quoted by the Court of Claims are, it is submitted, irrelevant to the thought Congress was expressing in the interest deduction exception clause and add nothing to a complete and sufficient expression of the thought Congress had in mind in adopting the word "purchase". In fact, if these technical, general, special and random definitions and synonyms are to be adopted as expressing the Congressional intent, it would impute to the Congressional mind either a strange confusion or an inability to express itself.

The definition—

> "Purchase: To obtain or secure as one's own by paying or promising to pay a price",

subject to the mental reservations that the property is acquired in a transaction of buying and that the price is money or money equivalent, is an acceptable equivalent of "purchase" of the exception clause,—otherwise not. Moreover, this definition, if its scope is not reduced by and within the limits of such mental reservations,

would not be the equivalent of "to purchase" because it would embrace acquisitions of property in transactions foreign to those of *purchase*, such as an acquisition of property in a transaction of *lending* on the security of such property. Incidentally, this definition recognizes that the price in respect of a purchase may be payable either at the time of purchase or subsequent thereto, and recalls the ostensible Congressional intent in adding in the 1918 Act the word "carry",—to indicate that indebtedness incurred or continued subsequent to the purchase, to pay the price promised at the time of purchase, is "indebtedness incurred *for the purchase of*" (*supra*, p. 21).

"Buying for money" (plus possibly but not necessarily the inference of payment at time of purchase) found in the remaining group of definitions adopted by the Court of Claims, to wit:

> "(3) To obtain (anything) by paying money or its equivalent; the acquisition of title to, or property in, anything for a price; *buying for money* or its equivalent."

reflects the plain and unadorned sense of the word "purchase" in the exception clause (A 3 (b) *supra*, p. 19). The other definitions in this group are, on the one hand, too broad as definitions of "purchase" in that they would include the acquisition of property by barter, rental for cash consideration, etc., and, on the other hand, are deficient in that they lack the connotation of "buying".

The plaintiff, submitting that a determination of the meaning of "to purchase" in the exception clause does not require reference to definitions or synonyms of the word purchase, points out that Webster's New International Dictionary (1929), although it sets forth numerous unrelated meanings of purchase (the transitive verb)

under six separate numerical headings, offers only one comment under the symbol "Syn.," which is—"See Buy." Turning to "Buy" we find, immediately following the symbol "Syn." the following:

> "Buy, Purchase are in meaning convertible terms."

and yet the Court of Claims (R. 22) infers that the plaintiff, in submitting that "to purchase" means "to buy for money or money equivalent" is proposing a "technical meaning different from that in which" it is "ordinarily used".

As to "carry",—it is submitted that all the definitions of the word carry adopted by the Court of Claims (R. 21-22) are foreign to the meaning of "carry" as used in the exception clause. Obviously a Joint Stock Land Bank does not borrow in respect of a farmer's first mortgage "to advance the money to pay his interest". We have seen (*supra*, p. 20) that the Income Tax Unit has not adopted the second definition, to wit, "to bear the charges or burden of *holding*" as distinguished from the burden of *purchase*. Likewise, the definition "to keep on one's books as a debtor" has the inference that the debt is past due, which inference, of course, is not present in the farmer's qualified first mortgage, which is and must be, in good standing. The final group of synonyms lacks the element of borrowing money to bear charges incident to a *purchase*. (A 3 (b) *supra*, p. 19.)

The Court of Claims not only substituted the general word "acquisition" as the equivalent of "purchase" but also adopted "holding" from a final group of synonyms (to wit, "to keep on hand; maintain; keep up; support; hold") as the equivalent of "carry".

If it be proposed that "carry" means "to keep on hand" or "hold" and signifies generally the act of "holding", divorced from any inference of bearing the

burden of acquisition and also divorced from any relation to the mode of acquiring possession (such as the burden of carrying the cost of acquisition by purchase) it rests, it is submitted, on the one proposing such meaning to justify the application of such meaning to the transaction Congress had in mind in adopting the exception clause.

Furthermore, if it be proposed that "carry", in some indefinite sense of "maintain; keep up; support", signifies the bearing of some indefinite burden incident to the mere possession of one of the specified securities and unrelated to the acquiring of such possession (as distinguished from bearing the burden of the cost of acquisition, *i. e.*, the purchase price, of one of the specified securities acquired by purchase,—either prior to or subsequent to the time the indebtedness is incurred or continued), it rests, it is submitted, on the proposer of such meaning to specify not only the nature of such burden but also to justify the application of such meaning to the transaction Congress had in mind in adopting the exception clause.

In the last analysis,—Congress originally in the 1917 Act used the single word "purchase" and in the 1918 and subsequent Acts substituted in lieu thereof, as being "substantially the same", the phrase "to purchase or carry", which is quite sufficient to express the Congressional intent in view of the purpose of the exception clause,—to wit, to deny the deduction of interest on indebtedness incurred or continued to provide the funds required to make or carry a purchase of the specified interest exempt securities. If this phrase is to be broken down and the words given independent unrelated meanings, or if the meaning of these words, jointly or independently, is to be extended beyond "the clear import of the language used", or beyond any direct meaning

necessary to the full purpose of the context, so as to mean "to acquire" (as distinguished from "to acquire by purchase"), "to bargain for", "to barter for", "to obtain", "to acquire by devise", "to carry" (as distinguished from "to carry" a purchase), "to hold", "to bear", "to keep on hand", "to maintain", "to support", the double burden of specifying the application of any such meanings and of reconciling such meanings with some Congressional intent would seem to fall on the one proposing such meanings (see *Gould* v. *Gould, infra,* p. 79).

Considering (a) the Congressional purpose (II A 2 *supra,* p. 14), (b) the rulings of the Internal Revenue Bureau, (c) the historical development of the phrase "to purchase or carry", and (d) the meaning of "carry" in financial parlance (II A 3 (b) *supra,* p. 19), it is submitted that the word "carry" (in common with "purchase") inescapably denotes an act in some manner connected with an acquisition by purchase of such specified obligations or securities and that, therefore, "carry" is predicated on and presupposes a purchase. In other words, it is submitted, unless the indebtedness has some relation to a purchase it is not *incurred or continued "to purchase or carry".*

It remains, therefore, to apply the facts to the law and determine whether a Joint Stock Land Bank's acquisition of a farmer's first mortgage involves, under the circumstances of the acquisition, a purchase of the first mortgage.

In acquiring a farmer's first mortgage (*i. e.* mortgage note and mortgage) at the time of inception, incidental and consequent to a particular loan (particularly when made on formal application therefor and subject to prior appraisal of land values and other conditions set forth in the Federal Farm Loan Act) a Joint Stock Land Bank

does not "*purchase*" the first mortgage, *i. e.*, either the mortgage note or mortgage. On the contrary, it is merely acquiring the mortgage note as evidence of the loan and acquiring the mortgage as security for the payment of the note.

Parenthetically, it would seem that the exception clause would involve only the *interest-bearing mortgage note* and not the *non-interest-bearing mortgage*, inasmuch as the exception clause covers only indebtedness "to purchase or carry" "obligations or securities the *interest* upon which is wholly exempt from taxation under this title". This distinction, however, does not control the determination of the issues. It has, nevertheless, a bearing on the argument *infra* and suggests that the unit term "first mortgage" (including both the mortgage note and the mortgage) should be visualized, in contemplation of the exception clause and exemption section (as distinguished from the Federal Farm Loan Act), as projecting the mortgage note rather than the mortgage.

Conversely, the giving of such first mortgage as evidence of and security for the payment of the loan is not, in ordinary usage or in fact, a *sale* by the farmer of his first mortgage. In the Federal Farm Loan Act the farmer is referred to as a "borrower" (Sec. 10); "borrowers on farm land mortgages" (Sec. 8); "applicant for a loan" (Sec. 12 Eighth); "every borrower who shall be granted a loan" (Sec. 12 Tenth); and "mortgagor" (Sec. 15). *Nowhere in the Act is there any suggestion that the farmer is a vendor or in any manner involved in the transaction of a purchase and sale.* Incidentally, the Court of Claims refers to the farmers as "borrowing landowners" (R. 24) and "borrowing farmers" (R. 25).

As we have seen, the purpose of the creation of Joint

Stock Land Banks, as expressly stated in the Federal Farm Loan Act (Sec. 16), was "for carrying on the business of *lending* on farm mortgage security and issuing farm loan bonds". The Joint Congressional Committee, *supra*, p. 31, states "Joint-stock land banks are not permitted to engage in any business but *making farm mortgage loans* and issuing bonds". In the Farm Loan Act all the language of Sec. 16, in respect of a Joint Stock Land Bank, proclaims its operations to be that of loaning and, moreover, refers to "mortgages *taken* by it in accordance with the terms of this Act". The word "taken" is quite an apt word, inasmuch as *all that any lender does is to "take" the borrower's note and security,—he does not "purchase" them.* To this effect also are the words "to receive" in Sec. 13 Third. Incidentally, the Court of Claims (R. 23) adopts the word "acquired" in respect of the transaction.

Some reference, however, should be made to the word "purchase" as used in Sec. 13 (Second) of the Federal Farm Loan Act which has to do specifically with the powers of Federal land banks (as distinguished from Joint Stock Land Banks), viz.: "to invest such funds as may be in its possession in the *purchase* of qualified first mortgages on farm lands situated within the Federal Land Bank district within which it is organized or for which it is acting". This particular language of purchase may have been intended by Congress as an additional power, distinct from the loaning power of a Federal land bank, *i. e.*, to purchase existing qualified first mortgages originated otherwise than through the corporate agencies, to wit, National Farm Loan Associations (Sec. 7, 8, 9, 10 and 11) and other corporate agencies (Sec. 15) through which Federal land bank loans (as distinguished from Joint Stock Land Bank loans) must be made. The acquisition of an existing mortgage from the

original lender or a subsequent holder in title is, in common usage, deemed a purchase, so the use of the word "purchase" in expressing such a power would be quite consistent with common usage. To the extent that Sec. 13 (Second) may have any application as descriptive of the *lending operations* of a *Federal land bank*, the word "purchase" would find justification in the fact that the National Farm Loan Associations and other corporate agencies (through which the loans of Federal land banks must be made) must endorse the farmer's mortgage and become liable for the payment thereof (Sec. 11 and Sec. 15). The use of the word "purchase" in respect of the acquisition of the farmer's mortgage from or through an intermediate obligor would be quite consistent with common usage. This is supported by the language in the only other section where language of purchase and sale is used, to wit, a paragraph in Sec. 15, which reads:

> "Any agent negotiating any such loan (for a Federal land bank) shall endorse the same and become liable for the payment thereof, and for any default by the mortgagor, on the same terms and under the same penalties as if the loan had been originally *made* by said agent *as principal* and *sold* by said agent to said land bank."

Incidentally, in this provision Congress again follows common usage in its distinction between the original acquisition of a mortgage note and mortgage in connection with a loan (being the making of a loan) and the acquisition of them in a transaction subsequent to the original loan transaction (such subsequent transaction being a purchase,—the disposal being a sale).

Final and clear evidence of the Congressional differentiation between a "loan on first mortgage" and a "purchase" is found in Sec. 22 of the Federal Farm Loan Act, which provides that "amortization and other

payments on the principal of first mortgages" shall be "applied or employed as follows":

"In the case of a Federal land bank—

(a) To pay off farm loan bonds issued by said bank as they mature.

(b) To *purchase* at or below par farm loan bonds issued by said bank or by any other Federal land bank.

(c) To *loan on first mortgages* on farm lands within the land bank district, qualified under this Act as collateral security for an issue of farm loan bonds.

(d) To *purchase* United States Government bonds.

In the case of a joint stock land bank—

(a) To pay off farm loan bonds issued by said bank as they may mature.

(b) To *purchase* at or below par farm loan bonds.

(c) To *loan on first mortgages* qualified under section sixteen of this Act.

(d) To *purchase* United States Government bonds."

It is submitted that a Joint Stock Land Bank's acquisition of a farmer's first mortgage, in connection with a simple direct loan to a farmer on his sole responsibility as to payment, is not and does not involve a "purchase" of the first mortgage. Both common usage and the language of the Federal Farm Loan Act, consistent with common usage, preclude application of the word "purchase" in any ordinary sense to such an acquisition,—and the word "purchase" was used in its ordinary sense in the interest deduction exception clause.

Failing a purchase, it follows that such indebtedness of a Joint Stock Land Bank is not incurred or continued "to purchase". Nor is it incurred or continued "to carry", inasmuch as the act denoted by carry is predicated on, presupposes and can be manifested only in connection with a purchase and, consequently, such in-

debtedness is not incurred or continued "to purchase or carry".

One final word as to "carry",—disregarding for the sake of the argument the clear dependence of "carry" on "purchase" with both revolving around a purchase, let us deprive "carry" of its meaning of "to bear the burden of acquisition *by purchase*" and substitute the meaning of "to bear the burden of holding after acquisition" or "to support after acquisition". Plaintiff, incidentally, confesses that it cannot conceive what such a burden would be in contemplation of the exception clause, but submits that it must be some burden accruing after acquisition because "carry" denotes possession. These latter meanings, it is submitted, represent the limit of any reasonable extension of the meaning of the word "carry". In the latter meanings, let us apply "carry" to the first mortgages acquired by a Joint Stock Land Bank as an incident to its loans.

Two classes of first mortgages are involved,—those already acquired in connection with past loans to farmers, and those to be acquired in connection with future loans to farmers. As to those already acquired, the farmer has received his full consideration and the Joint Stock Land Bank holds such first mortgages free, clear and unpledged. The Joint Stock Land Bank is under no necessity to do anything with these free, clear and unpledged first mortgages held by it. It can stop the process of flow and reflow of making loans and issuing bonds and retain these free first mortgages evidencing loans made with former borrowings. The bank is clearly under no necessity to borrow money to "bear the burden of holding" or "to support" them. It may, if it pleases, renew the process and use these free first mortgages as collateral security to borrow more funds to loan to farmers and acquire additional first mortgages, as contem-

plated in the Federal Farm Loan Act. One must ignore facts to say that such new borrowing is incurred or continued to "carry" these free first mortgages (used as collateral for the new borrowing),—inasmuch as they are free and clear in the hands of the Joint Stock Land Bank at the time of the borrowing and require no carry,—the farmer having received full consideration therefor.

As to the first mortgages to be acquired in the future, they likewise, since the farmers, respectively, have received full consideration at the time of acquisition through the loaning operation, are free and clear in the hands of the bank and require no "carry". Indebtedness incurred in expectation of making new loans and acquiring additional first mortgages is incurred to make the loans and not to "carry" the first mortgages subsequently to be acquired. In fact, a "carry" presupposes the existence and possession of the thing carried (be it a purchase or a security) and at the very moment the new first mortgages come into existence and into the possession of the Joint Stock Land Bank they are free and clear, so, obviously, the indebtedness incurred prior to such acquisition cannot be indebtedness incurred or continued "to carry" the future first mortgage because no "carry" eventuates.

To reduce this question to a simple equation, plaintiff submits that, so far as "purchase or carry" is concerned, a Joint Stock Land Bank's loaning to a farmer on his mortgage security and an ordinary bank's loaning to a customer on similar security are, in essence, the same. The note of the borrower is acquired by each as evidence of the loan and as security for the repayment of the loan each acquires a mortgage. Neither transaction, however, can be properly identified, in contemplation of the interest deduction exception clause, as being "to purchase or carry" the note or mortgage. The fact that the interest

on one note is exempt in respect of income tax and the interest on the other is not so exempt does not change the nature of either transaction.

To recapitulate briefly,—such indebtedness of a Joint Stock Land Bank is not within the literal meaning of "indebtedness incurred or continued to purchase or carry" in the interest deduction exception clause, in that, (a) the purpose of the indebtedness, in fact and as expressed by Congress, is simply to make loans to farmers, (b) the incidental acquisition of the farmers' first mortgages does not change such purpose or transmute it into that of "to purchase or carry" the farmers' first mortgages, and (c), even if the purpose of the indebtedness can be said to be to acquire the farmers' first mortgages, such acquisition does not involve a "purchase or carry". As to both purpose and use of the proceeds thereof, therefore, such indebtedness is not "incurred or continued to purchase or carry" farmers' first mortgages or, in fact, anything whatsoever. Therefore, at the threshold, it appears that such indebtedness of a Joint Stock Land Bank is not of the type designated in the interest deduction exception clause and the interest thereon is, therefore, deductible.

2.

THE FARMERS' FIRST MORTGAGES, IN ANY EVENT, ARE NOT "OBLIGATIONS OR SECURITIES THE INTEREST UPON WHICH IS WHOLLY EXEMPT FROM TAXATION UNDER THIS TITLE", TO WIT, TITLE II OF THE REVENUE ACT OF 1921, IN THAT—

(a)

THE INTEREST ON THE FARMERS' FIRST MORTGAGES IS NOT EXEMPT UNDER TITLE II OF THE REVENUE ACT OF 1921, IN THAT THE FIRST MORTGAGES DO NOT FALL WITHIN SEC. 213 (b) (4) (b) THEREOF AS "SECURITIES ISSUED UNDER THE PROVISIONS OF THE FEDERAL FARM LOAN ACT".

The defendant initially contends that the farmer's first mortgage on his farm, given as evidence of and security for the payment of the loan to him, falls within the scope of Sec. 213 (b) (4) (b), viz.: "securities issued under the provisions of the Federal Farm Loan Act", that consequently the interest on such mortgages is "exempt from taxation under this title", viz.: the Income Tax Law of 1921, and that, therefore, the farmers' first mortgages are "obligations or securities the interest upon which is wholly exempt from taxation under this title",— as specified in the exception clause.

The plaintiff submits that the phrase "securities issued under the provisions of the Federal Farm Loan Act" was intended to and in fact comprises only securities issued by Federal Land Banks and Joint Stock Land Banks and possibly National Farm Loan Associations and does not include the farmer's first mortgages. The soundness of this construction of this phrase will be apparent, it is submitted, from a brief consideration of (1) contemporaneous Congressional language, (2) the legislative history of the phrase, (3) the non-exemption in fact of the farmers' first mortgages under the Income

Tax laws, (4) rulings of the Internal Revenue Bureau, and (5) the exact language of the phrase.

(1)

Contemporaneous language of Congress is obviously good evidence as to the Congressional intent and meaning of the words. In other words, what are the "provisions of the Federal Farm Loan Act" in respect of the "issue" of "securities"? The Federal Farm Loan Act was finally passed and became law in July, 1916. In Section 26 of that Act the Congress said:

> "*First mortgages executed to* Federal land banks, or to joint stock land banks, and *farm loan bonds issued under the provisions of this Act* (Federal Farm Loan Act) shall be deemed" and so forth.

This language clearly negatives any intent of the Congress to attach to farmers' "first mortgages *executed to joint stock land banks*" the character of being "issued under the provisions of" the Farm Loan Act, and, conversely, expressly segregates and designates the bonds of Federal Land Banks and Joint Stock Land Banks as being "issued under the provisions of" the Farm Loan Act. Even the punctuation confirms this intent.

Furthermore, in the Federal Farm Loan Act the word "issue" is consistently and repeatedly linked with "bonds" and there is not an instance where the word "issue" is linked with "farmers' first mortgages", but, on the contrary, "first mortgages" are repeatedly designated as "qualified" (Sec. 13 (Second), 18, 19 and 22) or "*made*" (Sec. 19). In Sec. 18 of the Act it is provided that if a Joint Stock Land Bank shall vote "to *issue* farm loan bonds under this Act" it shall tender to the Farm Registrar as collateral security "first mortgages on farm lands *qualified under the provisions of* Sec. 12, etc. of this Act". Likewise another section

(Sec. 19) repeats the distinction in the two phrases "any *issue* of farm loan bonds *under the provisions of* Sec. 18" and "mortgages *qualified under Sec. 12, etc. of this Act*". Likewise the quotation from Sec. 22 of the Federal Farm Loan Act (*supra*, p. 48) refers in sub-heading (a) to "*farm loan bonds issued* by said bank" and, in sub-heading (c) to "*first mortgages qualified* under section sixteen of this Act".

Immediately following the passage of the Farm Loan Act, the Congress in formulating the Income Tax Law of 1916, added to the interest exemption Section 213—

> "securities issued under the provisions of the Federal Farm Loan Act".

The almost contemporaneous origin and adoption of "securities issued under the provisions of the Federal Farm Loan Act" confirms this phrase as being in the Congressional mind the equivalent of "farm loan bonds (*i. e.* bonds issued by Federal Land Banks and Joint Stock Land Banks, respectively) issued under the provisions of this Act", plus possibly additional securities (*infra*, p. 58),—excluding, however, the farmers' first mortgages.

Plaintiff submits that the above references to the Federal Farm Loan Act offer a clear manifestation of the Congressional intent as to the meaning of "securities issued under the provisions of the Federal Farm Loan Act" considered as a unit. Treating the phrase as a group of isolated words (attributing unrelated meaning and significance to each) not only makes more difficult any identification of the securities intended but also entails considerable discussion to show that the words, even if considered independently, do not fit together and into the Congressional intent and history unless they are given the meaning and significance which the context of the whole phrase would originally attribute to them.

(2)

The intent of this apparently clear language is confirmed by reference to the legislative history of the phrase "securities issued under the provisions of the Federal Farm Loan Act" as it appears in Section 213.

The Revenue Act of 1916 was introduced into the House of Representatives on July 5, 1916, almost two weeks prior to the effective date of the Farm Loan Act, to wit, July 17, 1916. This Revenue Act as introduced (H. R. 16783) as originally reported in the House (64th Congress, 1st Session, House Reports, Vol. 3, No. 922) and as first reported in the Senate (Senate Documents, 64th Congress, 1st Session, Vol. 39, Document No. 531) was silent in respect of "securities issued under the provisions of the Federal Farm Loan Act". There was no change from the 1913 Act. As late as August 16, 1916, when the Finance Committee of the Senate reported the 1916 Revenue Act out (Senate Reports, 64th Congress, 1st Session, Vol. 3, No. 973) there was no reference to such interest exemption, although the Federal Farm Loan Act had been effective for a month. Later when the 1916 Revenue Act was being discussed in the Senate and after all formal amendments proposed by the Finance Committee had been exhausted, Mr. Simmons, as Chairman of the Committee, proposed from the floor the exemption which ultimately became Paragraph Fourteenth of Section 11. He also at the same time added to the interest exemption Section 4, *which dealt with exemptions to individuals*, the following:

> "or securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916".

In the Congressional Record, Vol. 53, part 13, at the end of page 13792, appears the following:

Mr. Simmons: Mr. President, on page 34 of the

bill, at the end of line 11, under the exemptions in reference to securities of farm and Federal Land banks, and so forth, I desire to offer a new paragraph in these words:

> Joint-stock land banks as to income derived from bonds or debentures of other joint-stock land banks or any Federal land bank belonging to such joint-stock land bank.

That is an amendment suggested by the Secretary of the Treasury.

The President pro tempore: The Senator will send the amendment to the desk and it will be read.

The Secretary: On page 34, paragraph 'thirteenth' proposed by the committee, was passed over at the instance of the Senator from Utah. After that paragraph which has been passed over it is proposed to insert:

> Fourteenth. *Joint-stock land banks as to income derived from bonds or debentures of other joint-stock land banks or any Federal land bank* belonging to such joint-stock land bank.

The President pro tempore: Unless there is objection, the amendment offered by the Senator from North Carolina on behalf of the Finance Committee will be agreed to. The Chair hears no objection, and it is so ordered.

Mr. Simmons: On page 8, line 10, after the word 'possessions', I move to add *'or securities issued under the provisions of the Federal Farm Loan Act of July* 17, 1916'.

The amendment was agreed to."

These two amendments were adopted in conference and as to the latter the conference report (House Reports 64th Congress, 1st Session, Vol. 3, No. 1200, dated September 7, 1916), reads merely:

> "This amendment exempts securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916, from the income tax provisions, and the House recedes."

These two last minute equivalent amendments were the twin children of the same thought, one referring to an exemption to Joint Stock Land Banks and the other

to individuals. The amendment paragraph Fourteenth refers to *"bonds or debentures of other Joint Stock Land banks or any Federal Land Bank"* and the exemption granted to individuals said the same thing in *"securities issued under the provisions of the Federal Farm Loan Act of July* 17, 1916". *When the Congress first used the language "securities issued under the provisions of the Federal Farm Loan Act" it was used in connection with exemptions to individuals.* Any attempt therefore, to enlarge the scope of "securities issued under the provisions of the Federal Farm Loan Act" beyond *farm loan bonds* issued by the Federal Land Banks and Joint Stock Land Banks (available in the open market), so as to include "farmers' first mortgages *executed to Joint Stock Land banks"* not only ignores the historical equivalence of the two amendments but also imputes to Congress an intent to grant an exemption to an individual in respect of a farmer's first mortgage which cannot be issued (if issued) to an individual and which, in addition, is not immediately available for purchase by an individual and which, until recently (*infra*, p. 61), was thought to lose its tax-exempt status in the hands of an individual.

The defendant inquires as to why Congress said "securities issued under the provisions of the Federal Farm Loan Act" rather than "bonds issued under the provisions of the Federal Farm Loan Act",—if it meant the bonds. In reply, it will be noticed that the paragraph Fourteenth, which was suggested by the Secretary of the Treasury, refers to "bonds or debentures of other Joint Stock Land Banks". This was error, inasmuch as Joint Stock Land Banks and Federal Land Banks did not issue debentures, but in a last minute amendment from the floor, possibly with some doubt in his mind, the one who formulated the phrase apparently cautiously

used a blanket expression—"securities issued under the provisions of the Federal Farm Loan Act". Under Sec. 11, Fourth, of the Federal Farm Loan Act National Farm Loan Associations have the power "to *issue* certificates against deposits of current funds bearing interest for not longer than one year not to exceed four per cent per annum after six days from date". It does not seem likely that such certificates of deposit could have been contemplated in the phrase "debentures of other Joint Stock Land Banks" as used by the Secretary of Treasury or his adviser. These certificates of deposit, however, are "issued under the Act" and, linked with the Farm Loan Bonds of Federal Land Banks and Joint Stock Land Banks, would justify the use of the word "securities" rather than the words "farm loan bonds" at the beginning of the phrase "securities issued under the provisions of the Federal Farm Loan Act". Incidentally, it might not be amiss to inquire of the defendant why Congress did not say "securities issued and first mortgages executed under the provisions of the Federal Farm Loan Act",—if it meant to include the first mortgages.

(3).

Further confirmation that farmers' "first mortgages executed to Joint Stock Land banks" are not "securities issued under the provisions of the Federal Farm Loan Act" in Section 213, is found in the fact that historically the interest on such first mortgages is not exempt under Section 213. It would be, of course, if such first mortgages were "securities issued under the provisions of the Federal Farm Loan Act". So far as anything in the Income Tax Law of 1916 is concerned, interest on the farmers' first mortgage notes was taxable income to Joint Stock Land Banks, inasmuch as paragraph Four

teenth exempts only "income from bonds or debentures of other Joint Stock Land banks or any Federal land bank". It is only the exemption granted in Section 26 of the Farm Loan Act which would prevent taxation under the 1916 law of the farmers' mortgage notes. So, directly contrary to the Government's contention, *interest* on the *first mortgages* rather than being exempt to Joint Stock Land Banks was taxable *under the* 1916 *Income Tax Law.* It remains, therefore, to see if there has been any subsequent change in the meaning of the phrase "securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916". Coming to the provisions of the Revenue Act of 1918 in these respects, we find that the Revenue Act of 1918 was set up under new titles and new sub-heads but the exemptions *as to individuals* contained in Section 4 of the 1916 Act were retained in Section 213 (b) (4) (b) of the 1918 Act, to the effect that interest upon the "securities issued under the provisions of the Federal Farm Loan Act" was exempt from taxation. This was the same exemption, no more no less, as that contained in Section 4 of the 1916 Act. The report of Ways and Means Committee of the House of Represetnatives (65th Congress, 2nd Session, H. R. Vol. 2, Report No. 676), in reporting the 1918 Revenue Act, states:

> "The bill (Section 212), defines net income to mean the gross income as defined in Section 213 less the deductions allowed by Section 214. Gross income will include the same items of income as are included under the present law,"

with exceptions not pertinent to this discussion. And again:

> "Section 214 of the bill allows the same deductions from gross income as under existing law,"

with exceptions not pertinent to this discussion.

By Section 233 of the Revenue Act of 1918, the gross income *of corporations* is made the same as the "gross

income as defined in Section 213" in respect of *individuals*,—with certain exceptions not pertinent to this discussion.

In this report of the Committee of Ways and Means, referring to Section 234 dealing with deductions allowed *corporations*, the Committee says:

> "* * * the bill * * * contains the *same limitations* in respect to the *tax free interest* received by the *corporation* which is applied in the case of an *individual*. The matter is discussed under the head '*deductions*' *under the portion of this report relating to the individual income tax.*"

From the above it is obvious that the 1918 Revenue Act exemption of income from "securities issued under the provisions of the Federal Farm Loan Act" was borrowed from the 1916 Revenue Act, and the words "securities issued under the provisions of the Federal Farm Loan Act" meant exactly what they meant in the 1916 Act.

The next step is to follow the clause "securities issued under the provisions of the Federal Farm Loan Act" into the 1921 Act and here again we find that it means exactly what it meant in the 1916 Act, no more no less. The Revenue Act of 1921 (H. R. 8245, 67th Congress, 1st Session, Vol. 8, Senate Document No. 73) when originally introduced, contained the same language as Section 213 (b) (4) (b) and Section 214 in respect of individual income taxability, and the same language as Section 233 and Section 234 of the 1918 Act in respect of corporate income taxability. Although there was considerable amendment in the Senate and the Bill was changed to a great extent, both as to form and as to substance, by the Senate, these Sections came through as set out in the original House Bill, and the reports in the Senate and in the House and the Conference reports,

so far as the writer has been able to discover, make no mention of these provisions.

(4).

The rulings of the Internal Revenue Bureau indicate quite clearly this limited scope of the phrase "securities issued under the provisions of the Federal Farm Loan Act". For instance, the Income Tax Unit in construing the Revenue Act of 1921 holds:

> "The net income of joint-stock land banks is subject to Federal income tax. If such a bank borrows money from other banks and gives its interest-bearing notes for the same, the interest paid by the joint-stock land bank to the holders of the notes is subject to Federal income tax to the same extent as interest derived from other promissory notes, as promissory notes of joint-stock land banks do not enjoy a tax-exempt status with reference to interest paid upon the loans they cover." (Internal Revenue Bureau Cum. Bull. II-29-1145; I. T. 1806 p. 92; Dec. 1923.)

The Unit quite correctly determines that a *note given by a Joint Stock Land Bank*, a Federal agency owing its existence to the Federal Farm Loan Act, does not "enjoy a tax-exempt status". It would, of course, if it were a security "issued under the provisions of the Federal Farm Loan Act". If the promissory note *of a Joint Stock Land Bank* does not fall within the phrase "securities issued under the provisions of the Federal Farm Loan Act", clearly a *farmer's* mortgage note "executed to" a Joint Stock Land Bank does not fall within the phrase "securities issued under the provisions of the Federal Farm Loan Act".

In I. T. 2470, Cum. Bull. VIII-17-4181, the Unit had occasion to determine the much debated question whether the interest on a farmer's first mortgage was exempt

from income tax in the hands of an individual to whom it had been sold by a Federal Land Bank. Obviously, if such first mortgage fell within the phrase "securities issued under the provisions of the Federal Farm Loan Act" in the interest exemption section the interest on such note would be exempt beyond question. The Unit, however, did not place its ruling upon any such basis but, on the contrary, quoted Sec. 26 of the Federal Farm Loan Act as follows:

> "First mortgages executed *to* Federal land banks * * * shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the *income* derived therefrom shall be exempt from Federal * * * taxation. (Italics supplied.)"

and held that the exemption granted in Sec. 26 to the farmer's mortgage note was a continuing exemption in the hands of an individual to whom it had been sold. The unit adopted, it is submitted, a very extended construction of Sec. 26 of the Federal Farm Loan Act when the same result could have been easily reached under the exemption section of the Income Tax Law, if it were a fact that the farmer's first mortgages fall within the phrase "securities issued under the provisions of the Federal Farm Loan Act".

(5).

The exact language of the phrase "securities *issued* under the provisions of the Federal Farm Loan Act" confirms the limited and exact scope of this phrase. In the first place, as we have seen, the Congress in Sec. 26 of the Federal Farm Loan Act indicated its intent when it referred to the farmers' first mortgages as being "executed" and the farm loan bonds as being "issued". As the Joint Congressional Committee, in referring to

Joint Stock Land Banks, said in its report (*supra*, p. 30):

> *"they will be permitted to make loans, and to issue farm loan bonds under the supervision of the farm loan board."*

In the second place, assuming for the argument that the word "issue" is in any sense applicable to the isolated act of the farmer in giving his note and mortgage (see *infra*, p. 66), both the farmers' mortgage notes and mortgages are, in legal contemplation, *issued* under the provisions of the respective States of Illinois, Iowa, Texas and Oklahoma and are not *"issued* under the provisions of the *Federal Farm Loan Act"*.

As to the mortgage note, it derives its vitality and legal status from the local State law and not from the Federal law. To be sure the Federal Farm Loan Act prescribes certain requirements in respect of the rate of interest, maturities, etc. but such are merely limitations superimposed in respect of certain attributes of the note originating under the State laws. There would be no note or interest thereon or maturity thereof in the absence of the local law recognizing the legal status and effect of a promissory note and fixing its attributes.

As to the mortgage (standing alone),—it may be questioned whether the non-interest-bearing mortgage (regardless of whether it is "issued under the provisions of the Federal Farm Loan Act") is within the scope of the interest-bearing "obligations or securities" of the exemption section,—not being interest-bearing it cannot be in the class of "securities" the "interest upon" which is exempt. Nevertheless, to meet any suggestion that the mortgage note and mortgage are to be considered as a unit and that, therefore, the attributes of the mortgage reflect themselves in the mortgage note, let us inquire if the mortgage falls within the scope of "se-

curities issued under the provisions of the Federal Farm Loan Act".

A local State statutory form of mortgage is commonly used. It is true that they are made so as to conform with certain provisions of the Federal Farm Loan Act, as contended by the defendant, so that they will be "qualified" and available to the Joint Stock Land Banks as collateral security for the issue of bonds. Such, however, does not stamp them as within the phrase "issued under the provisions of the Federal Farm Loan Act" and no intent of Congress so to stamp them has been disclosed. Provisions under the Federal Farm Loan Act in respect of these mortgages are merely restrictions on the Joint Stock Land Bank. Absolutely valid first mortgage notes and mortgages conforming in all respects with the restrictions imposed by the Act may be created without reference to the Farm Loan Act and, on the other hand, a mortgage loan made by a Joint Stock Land Bank in good faith which may ultimately be unacceptable to the Registrar as a qualified "first mortgage" is nevertheless a valid subsisting mortgage,—clearly indicating that the mortgages (if issued) are "issued" under the State laws.

A farmer's mortgage does not trace its 'issuability' to the Federal Farm Loan Act but, on the contrary, derives its vitality and legal status and effect solely from the law of the State in which it is effective,—this applies even down to the incidences of the mortgage, such as the period of redemption allowed the mortgagor in the event of foreclosure.

It is true that Joint Stock Land Banks exist only by virtue of the Federal Farm Loan Act and farmers' mortgages are essential elements of the farm loan scheme, but such does not classify farmers' mortgages

as "issued under the provisions of the Federal Farm Loan Act". A mortgage received by an Illinois corporation, for instance, would not be "issued under the provisions of" the Illinois statute under which such corporation was created, but would be "issued under the provisions of" the conveyancing statutes of Illinois.

Furthermore, ordinary mortgage bonds, owing their origin to the laws of a particular State, contain provisions which will meet the requirements of the laws of other States so that they will be acceptable to purchasers in view of these statutory requirements, as to taxes for instance, but it does not follow that the bonds are "issued under the provisions of" the laws of these other States. Many real estate mortgages are deliberately set up in respect of the terms and margin of security and so forth, so they will be acceptable for trust fund investment in contemplation of various States' statutes regulating trustees in the investment of trust funds, and yet such mortgages are "issued under the provisions of" the local law and are in no way "issued" under the provisions of the various States' statutes regulating trustees in respect of investment of trust funds.

In conclusion, as we have seen, obligations the interest on which was originally exempted in the income tax law exemptions were obligations or securities of a State, Territory, or any political subdivision thereof, or the District of Columbia, or obligations of the United States or its possessions. These were Government obligations. To these subsequently were added bonds of War Finance Corporation,—a distinct Government agency, and "securities issued under the provisions of the Federal Farm Loan Act". It is submitted that the latter were intended to comprise only the securities issued by Governmental agencies, to wit, the Federal Land Banks and the Joint Stock Land Banks, and these securities are Federal Land

Bank Bonds, Joint Stock Land Bank Bonds, National Farm Loan Association Certificates of Deposit, and, since the amendment to the Federal Farm Loan Act approved March 4, 1923, Federal Intermediate Credit Bank Debentures. Incidentally, the word "securities issued under the provisions of the Federal Farm Loan Act" has expansive flexibility. The obligations and securities on which interest is exempt in Section 213 of the Income Tax Law are only ones of high rank and dignity, as established by their contextual relationship. *There is nothing which would delude a farmer's "first mortgage" into the belief that it could mingle in the society of such "obligations or securities".*

In the third place, it is doubtful if ordinary usage countenances the application of the word "issue" in any literal sense to the act involved in the inception and giving by a farmer of an individual mortgage on his farm in connection with a particular loan based on a particular appraisal of values, etc. We speak of corporate bond *issues*, but the borrower of money on the security of his farm or home, evidenced by a single mortgage instrument, "gives" or "makes" rather than "issues" his mortgage.

It is submitted, therefore, that (1) contemporaneous Congressional language, (2) the legislative history of the phrase, (3) the non-exemption in fact of farmers' first mortgages under the Income Tax Law of 1921, (4) the rulings of the Internal Revenue Bureau, and (5) the exact words of the phrase, manifest clearly that the farmers' "first mortgages *executed to* joint stock land banks" do not fall within the phrase "securities issued under the provisions of the Federal Farm Loan Act" as used in Sec. 213 (b) (4) (b) of the Income Tax Law of 1921. If they do not fall within this particular phrase they admittedly do not fall within Sec. 213 (b) (4) and

are, therefore, not "obligations or securities the interest upon which is wholly exempt from taxation under this title", to wit, Title II of the Revenue Act of 1921, commonly referred to as the Income Tax Law of 1921.

Comment on Opinion Below.

May brief comment be made on the opinion below on this point, so as to avoid possible misunderstanding of the plaintiff's argument here and in the court below. Plaintiff's major contention below on this point was, as it is here, that the farmers' first mortgages are not within the scope of "securities issued under the provisions of the Federal Farm Loan Act",—designated in the *exemption section* (and consequently not within "obligations or securities the interest upon which is wholly exempt from taxation under this title",—designated in the exception clause). In addition, plaintiff contended below, as stated by the Court of Claims (R. 22, middle of page) that the farmers' first mortgages are not obligations or securities in contemplation of the *exception clause* in that the words "obligations or securities" as used in the exception clause (apart from refinements of the meaning of "exempt from taxation under this title") comprehend only a special class of obligations or securities (to wit, those similar in type to those mentioned in the exemption section) and not obligations and securities in general (*infra*, p. 74),—plaintiff conceding below, as it does here, that the farmers' first mortgages (more particularly the notes) are generally speaking obligations and securities and expressing no dissent from the definition of securities adopted by the Court of Claims (R. 23) as follows:

> "Securities (plural)—Is in use as a general form for written assurances for payment of money; evidences of debt."

The Court of Claims (possibly misled by the order or language of the plaintiff's brief into a misconception of the plaintiff's contentions) fails in its reasoning (R. 22-26) to consider either of the plaintiff's contentions. The Court, although it initially addresses itself (R. 22) to the second contention of the plaintiff, which is directed to the scope of the words "obligations or securities" in the *exception clause*, proceeds to demonstrate that the farmers' mortgage notes and mortgages are, generally speaking, obligations and securities and that, because the farmers' first mortgages can be and are used as "collateral security" under Sec. 18 of the Federal Farm Loan Act, they are securities in contemplation of the *Federal Farm Loan Act*, which, plaintiff submits, is irrelevant and in respect of which plaintiff made (and now makes) no contention,—notwithstanding that the Court (R. 24) attributed such a contention to the plaintiff.

The Court, without any consideration of the meaning of "securities issued under the provisions of the Federal Farm Loan Act",—in the *exemption section* and without further reference (other than to state the contention) to the scope of "obligations or securities" in the *exception clause*, concludes that the farmers' first mortgages are "*securities under* the provisions of *the Federal Farm Loan Act*" and that, consequently, the interest thereon is exempt from taxation under Sec. 213 (b) (4) of the Income Tax Law. Plaintiff submits that not only is it immaterial whether the farmers' first mortgages are "*securities under* the provisions of the Federal Farm Loan Act", *i. e.*, securities in contemplation of the Federal Farm Loan Act, but also that Sec. 213 (b) (4) of the Income Tax Law contains no exemption in respect of interest on "*securities under* the provisions of the Federal Farm Loan Act".

Coming to a consideration of what applciation the reasoning of the Court of Claims may have in the interpretation of "securities *issued* under the provisions of the Federal Farm Loan Act",—plaintiff concedes, as it did below, that the farmers' mortgage notes (and first mortgages as including mortgage notes) are securities in the sense of "written assurances for payment of money" which, it is submitted, is (with the added element that they bear interest) the sense of "securities" in subsection (b) of the exemption section, so it is not necessary to prove this fact. Such does not, however, make them "securities issued under the provisions of the Federal Farm Loan Act".

Parenthetically, plaintiff submits that the fact that the farmers' mortgages are "security" for the payment of the farmers' mortgage notes does not make them "securities" in contemplation of the exemption section and that "security", in the sense of meaning something given, deposited or pledged to secure the payment of a debt,—as set forth in the definitions adopted by the Court of Claims (R. 22, 23), does not reflect the meaning of "securities" in the exemption section. Such a meaning would exclude even *farm loan bonds* from the phrase "securities issued under the provisions of the Federal Farm Loan Act",—inasmuch as such bonds are not used, in contemplation of the Federal Farm Loan Act, to secure the payment of a debt, (*i. e.*, as security) but are, nevertheless, not only "securities" but concededly and obviously "securities issued under the provisions of the Federal Farm Loan Act". Incidentally, the farmer's first mortgage, even in the sense of "security", is not "issued" by the Joint Stock Land Bank (as are its bonds) but, on the contrary, is merely deposited by way of pledge as security for the issue of farm loan bonds or, as stated in Sec. 22 of the Federal Farm Loan Act,

"any first mortgage • • • *pledged* as collateral security for the *issue* of farm loan bonds".

Plaintiff submits that the fact that farmers' first mortgages (*i. e.*, both mortgage notes and mortgages) are referred to as "collateral security" in Sec. 18 of the Federal Farm Loan Act and under said Act may be and are used as collateral security against the issue of Joint Stock Land Bank Bonds, does not give the farmers' first mortgages the status of "securities issued under the provisions of the Federal Farm Loan Act". The very language of Sec. 18, referred to by the Court, disproves, it is submitted, any such conclusion. Sec. 18 provides that if a Joint Stock Land Bank votes *"to issue farm loan bonds under this act"* it shall make application and tender therewith to the farm loan registrar "as collateral security *first mortgages* on farm lands *qualified under the provisions* of section twelve, section fifteen, or section sixteen *of this Act*, or *United States Government bonds*, not less in aggregate amount than the sum of the *bonds* proposed to be *issued*".

In the first place, the bonds are *issued* and the first mortgages are *qualified* under the Act. Obviously, the phrase "securities issued under the provisions of the Federal Farm Loan Act" is not given its literal interpretation if the word "issued" is ignored (as it apparently was by the Court of Claims) or if there is substituted for the word "issued" any of the following words: "executed to", "qualified" and "taken",—which are the words used in the Federal Farm Loan Act as descriptive of the farmers' first mortgages.

In the second place, United States Government bonds may be used *pari passu* in lieu of farmers' first mortgages as "collateral security". If farmers' first mortgages by virtue of being used as "collateral security"

become "securities issued under the provisions of the Federal Farm Loan Act" then, by the same token, *United States Government bonds become "securities issued under the provisions of the Federal Farm Loan Act"*. The Court of Claims (R. 24), sensing this difficulty, interpolated the following:

> "While bonds of the Government of the United States are authorized to be tendered and used as collateral security for farm loan bonds, it is a matter of common knowledge that they are not so used by joint stock land banks for that purpose to any appreciable extent."

One final comment on the reasoning of the Court of Claims, the Court (R. 24, 25) refers to Sec. 26 of the Federal Farm Loan Act and Opinion of the Attorney General as supporting the point that "Congress intended to make the notes and first mortgages of borrowing landowners, securities, by the language used in Sec. 18 of the Federal Farm Loan Act" (R. 24, bottom). Plaintiff, repeating that the fact that the farmers' first mortgages are "securities" is conceded, submits that Sec. 26 of the Federal Farm Loan Act (see *supra* p. 53) and the Opinion of the Attorney General (see *supra* p. 33) distinctly indicate that the farmers' first mortgages are not within the scope of "securities issued under the provisions of the Federal Farm Loan Act".

Plaintiff submits, therefore, that the conclusion of the Court of Claims that the farmers' first mortgages are "securities under the provisions of the Federal Farm Loan Act" does not meet the points at issue and, further, that, although the Court of Claims in one place (R. 22) refers in passing to farmers' first mortgages as "executed and issued under the provisions of the Federal Farm Loan Act", the reasoning of the Court does not justify either a conclusion that the farmers' first mortgages are "securities issued under the provisions

of the Federal Farm Loan Act" (the major contention of the plaintiff on this point) or a conclusion that the farmers' first mortgages are "obligations or securities" in contemplation of the meaning of the interest deduction exception clause (the second contention of the plaintiff).

The balance of the opinion of the Court of Claims is addressed to other considerations, which will be referred to later (*infra* p. 80).

(b)

THE FARMERS' FIRST MORTGAGES DO NOT FALL WITHIN "OBLIGATIONS OR SECURITIES THE INTEREST UPON WHICH IS WHOLLY EXEMPT FROM TAXATION UNDER THIS TITLE" AS A CONSEQUENCE OF ANY TAX EXEMPTION DERIVED EXCLUSIVELY FROM THE INCIDENTAL PROVISIONS OF THE FEDERAL FARM LOAN ACT.

The defendant contends, secondarily and in the alternative, that (even though the farmers' first mortgages do not fall within Sec. 213 (b) (4) of Title II of the Revenue Act of 1921 as "securities issued under the provisions of the Federal Farm Loan Act" and consequently are not obligations or securities the interest upon which is wholly exempt under this title) the farmers' first mortgages and the "income" thereon are exempt under Sec. 26 of the Federal Farm Loan Act and consequently (the interest on said first mortgages, as one phase of "income" thereon, being exempt from income tax) the first mortgages fall within "obligations or securities the interest upon which is wholly exempt from taxation under this title". In other words, plaintiff submits, the defendant urges an interpretation which, ignoring the historical and contextual relation between the interest deduction exception clause and the interest exemption section of the Income Tax Law (Sec. 213 (b) (4)), deprives

the phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title" of any significance as a descriptive unit in its entirety and, segregating and construing the words "exempt from taxation under this title" as the equivalent of exempt from the tax imposed by this title, applies such construction, without reference to any specific Congressional intent, to any and all obligations or securities, provided, of course, they are interest-bearing. Such an interpretation must, obviously, rest on more than mere assertion. The Court of Claims did not refer to this contention,—possibly deeming it unnecessary in view of its holding on the other point.

The plaintiff submits that the Congressional purpose in adopting the interest deduction exception clause (*supra* p. 14), the interrelation of the wording of the interest deduction exception clause and the exemption section of the Income Tax Law (*supra* p. 24), and the fact that Congress specified in the exemption section each and every interest-bearing obligation or security available in the open market for purchase by anyone seeking to get the double benefit of an *interest deduction* on indebtedness and an *interest exemption* on securities purchased, indicates clearly that the Congress meant by the phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title" only obligations or securities specified in the exemption section of the Income Tax Law (Sec. 213 (b) (4)). In other words, the "obligations or securities the interest upon which is wholly exempt from taxation under this title" are the obligations and securities listed in the interest exemption section and specified therein as "obligations" "or" "securities" "the interest upon" "which shall be exempt from taxation under this title."

Any contrary interpretation of the interest deduction exception clause, arrived at by breaking down the clause into three parts, to wit, "obligations or securities", "the interest upon which" and "is wholly exempt from taxation under this title", and attributing to each of such parts an unrelated significance, should, in view of the above evidence of Congressional intent, be rejected,—unless clear manifestation of Congressional intent in support thereof can be adduced.

As we have seen (*Appeal of Greenville, supra,* p. 22), "obligations or securities" in the exception clause are not tax-exempt obligations or securities in general, such as "stocks",—whether interest-bearing or dividend-bearing, and are clearly not securities of a non-interest-bearing character. The words "the interest upon which is wholly exempt from taxation under this title" must be treated as a unit describing the obligations or securities intended. The giving of an independent and unrelated status to the words "the *interest* upon which" entails the conclusion that the Congress, in drafting the exception clause, was *arbitrarily* penalizing the purchase of all obligations or securities which carry *interest,* as distinguished from obligations or securities which carry *dividends* or *rents, issues and profits.* Clearly this is not so, and the Congress, in drafting the interest deduction exception clause, was, obviously, denying the deduction of interest on indebtedness incurred to purchase not tax-exempt obligations or securities but definitely visualized "obligations or securities",—again not those which, by chance, bore interest (and were tax-exempt) but those "the *interest* upon which is wholly exempt from taxation under this title". All obligations and securities listed under the exemption in Sec. 213 (b) (4) of the Income Tax Law carry interest as distinguished from dividends or rents, issues and profits. These

"obligations" or "securities" listed in the exemption section (Sec. 213 (b) (4)), being exclusively interest-bearing obligations or securities, it was natural for the Congress, in phrasing the *exemption* section to provide that the *interest* on these obligations or securities shall be "exempt from taxation under this title" (see Appendix) rather than providing that, say, the "income" should be exempt. Furthermore, the "obligations" or "securities" listed in the exemption section being those which were available in large quantities in the open market for purchase with borrowed money and being, moreover, exclusively interest-bearing obligations or securities, the Congress, in phrasing the *interest deduction exception clause*, which was designed to "discourage this practice" of borrowing money to purchase such securities, automatically identified them as "obligations or securities the *interest* upon which is wholly exempt from taxation under this title",—in other words, the interest-bearing "obligations or securities" referred to in the interest exemption section (Sec. 213 (b) (4)). The alternative interpretation of the defendant also ignores the significance of the use of the words "exempt from taxation under this title" in both the exception clause and the exemption clause.

Congress, it is submitted, in the phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title", used simple and direct phraseology to define the exemptions in mind,—those in the exemption section, and, therefore, there is no justification, in the absence of clear manifestation of Congressional intent to the contrary, for the seeking out of possible secondary meanings of the phrase,—even assuming such secondary meanings do not do violence to the exact language.

Finally, even aside from all the above considerations,

plaintiff submits that the defendant's proposed construction of "exempt from taxation under this title" does violence to the language itself. Space forbids elaborate itemization but a reading of the language of the Income Tax Law (see Appendix) indicates that the phrase "exempt from taxation under this title" was intended to designate exemptions under this title, and the words "from taxation" are adverbial (adhering to the verb "exempt"),—if, in fact, they are not fortuitous. In Sec. 1207 of the Revenue Act of 1917 (see Appendix) is found the progenitor of this phrase, in the following language:

> "except on indebtedness incurred for the purchase of obligations or securities the *interest upon which is exempt from taxation as income under this title.*"

Clearly, in this clause, which was the original exception clause, the phrase "from taxation" is either fortuitous or must be read as adhering to the verb "exempt" rather than adhering to "under this title". Again, in Sec. 213 of the 1918 Act (see Appendix) we find the phrase:

> "only if and to the extent it is *wholly exempt from taxation to the taxpayer* under this Title and under Title III."

Here again the phrase "from taxation" is obviously adverbial or fortuitous. Again in the deduction section of the 1918 Act (see Appendix) we find:

> "the interest upon which is wholly *exempt from taxation* under this title *as income to the taxpayer.*"

Here again "from taxation" is either adverbial or fortuitous. Certainly it could not mean "exempt from the *tax imposed by this title as income to the taxpayer*".

Further, plaintiff submits that the defendant, if it asks this Court to hold that the Congress intended "exempt from taxation under this title" to mean exempt

from the tax imposed by this title, should demonstrate to this Court wherein the Congress manifested such intent and also why the Congress did not express such an intent in simple language. We have seen that the Congress did not intend to deny deduction of interest on indebtedness incurred to purchase *tax-exempt securities*, so it is understandable why the Congress did not use the phrase "tax-exempt obligations or securities" in lieu of "obligations or securities the interest upon which is wholly exempt from taxation under this title". If, however, Congress had in mind the denial of interest deduction on money borrowed to purchase any and all *interest-bearing* obligations or securities, it might well have adopted the exact language proposed by the defendant as the equivalent of the language used, because the phrase "tax imposed by" is not foreign to the Income Tax Law. It is found in all Acts at least as far back as the 1916 Act. It appears in various forms, "tax imposed by Title II", "income tax imposed by subdivision", etc. In the 1921 Act (the one at issue) a rough calculation indicates that the phrase *"tax imposed by"* "this section", "this title", "this subdivision" or "this Act", etc., appears at least twelve times. In fact, in Sec. 234 (a) (2) itself, under which the exception clause falls (*supra* p. 6), Congress used the phrase "tax imposed by" and yet in the exception clause thereof used the phrase "wholly exempt from taxation under this title". If such were the intention of the Congress or the law it would have been quite simple and natural to say, in the interest deduction exception clause, obligations or securities the interest upon which is "wholly exempt from the tax imposed by this title".

In conclusion, Sec. 26 of the Federal Farm Loan Act grants to *first mortgages* and the *"income"* derived therefrom an exemption from Federal, State, Municipal

and local taxation. This is the broadest exemption known to the law and includes (excluding estate and inheritance taxes) exemption from all types of taxation. The interest on the farmers' first mortgages is one phase of the "income" derived therefrom and, as such, is exempt under this broad exemption granted solely to serve the purpose Congress had in mind in creating the farm loan system (*supra*, p. 31). The defendant, working backwards from its alternative interpretation of "exempt from taxation under this title", neglects to demonstrate what immediate or direct significance this incidental (though essential) exemption conferred on such interest by Sec. 26 of the Federal Farm Loan Act, had in the Congressional mind when it was framing the interest deduction exception clause for the purpose of denying interest deduction on indebtedness incurred to purchase "obligations or securities the *interest* upon which is wholly exempt from taxation under this title". In view of the fact that the farmers' first mortgages were not and are not for sale in the open market and, therefore, not currently the subject of purchase with borrowed money, it is quite inconceivable that the Congress, in framing the interest deduction exception clause for the purpose of defeating the practice of purchasing "obligations or securities the *interest* upon which is wholly exempt from taxation under this title" did or could (intelligently) contemplate or attach any significance to this exemption conferred on the first mortgage interest under the blanket "*income*" exemption of Sec. 26 of the Federal Farm Loan Act.

D.

ANY INTERPRETATION THAT SUCH INDEBTEDNESS OF A JOINT STOCK LAND BANK FALLS WITHIN THE EXCEPTION CLAUSE REQUIRES AN EXTENSION BY IMPLICATION OR ENLARGEMENT OF THE PROVISIONS OF THIS CLAUSE, WHICH IS CONTRARY TO RULES LAID DOWN BY THIS COURT FOR THE INTERPRETATION OF STATUTES LEVYING TAXES.

Plaintiff submits, without repetition of argument or reasons, that the interpretations urged by the defendant and also the interpretation adopted by the Court of Claims are incompatible with the rules laid down by this Court for the interpretation of statutes levying taxes.

In *Gould* v. *Gould*, 245 U. S. 151, (p. 153) is the oft-quoted and oft-followed statement:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government and in favor of the citizen. *United States* v. *Wigglesworth*, 2 Story, 369; *American Net & Twine Co.* v. *Worthington*, 141 U. S. 468, 474; *Benzinger* v. *United States*, 192 U. S. 38, 55."

The defendant, proceeding on the *letter* of the exception clause and confining its argument thereto, projects interpretations (in the alternative in one aspect) which it submits are within the strict letter of the statutes at issue but which, plaintiff submits, are not true literal interpretations, even treating the statutes as isolated words, and are clearly not true literal interpretations in the light of the purpose and intended scope of the interest deduction exception clause, considered in conjunction with the exemption section of the Income Tax Law and the Federal Farm Loan Act. Plaintiff further con-

tends that in the light of the purpose and intended scope of the interest deduction exception clause, the interpretations urged by the defendant extend the scope of the exception clause and the exemption section by implication "beyond the clear import of the language used" and enlarge their scope so as to "embrace matters not specifically pointed out".

Comment on Opinion Below.

The Court of Claims, in reaching its interpretation, it is respectfully submitted, ignored not only the *purpose and intended scope* of the interest deduction exception clause and its relation to the other statutes involved but also the *letter* of the interest deduction exception clause, also of the interest exemption section and also of the Federal Farm Loan Act,—*apparently influenced by several considerations which neither the plaintiff nor the defendant urged and other considerations which neither party urged or deemed pertinent to the issue when the matter was originally presented to the Court of Claims,* but which, in view of the statements contained in the original opinion of the Court of Claims, came into the case at the time of the rehearing before the Court below. In view of the stress placed on these several considerations by the Court below in its second opinion, comment thereon, at the risk of prolonging the argument, seems to be required.

The latter portion of the opinion below (R. 26, middle, to 31, incl.) is all predicated on the premise that the exception clause comprehends indebtedness incurred to purchase or carry "*tax-exempt*" obligations or securities (R. 30-31) or (R. 31) "the farmers' *tax-exempt* notes and first mortgages" because they are "securities under the provisions of the farm loan act",—note again

the absence of the word "issued". The language of the exception clause *per se*, it is submitted, clearly precludes such a premise and, furthermore, the plaintiff does not understand that the defendant adopts any such premise.

Proceeding on this premise, the Court of Claims, quite properly, holds that it is not justified in rewriting the exception clause (R. 31) in order to take such Joint Stock Bank indebtedness out of its provisions and, further, that it finds no provisions in the Federal Farm Loan Act (R. 31) which would take such Joint Stock Land Bank indebtedness out of the provisions of the exception clause. The plaintiff did not below, and does not here, ask the Court to rewrite the exception clause and does not urge that there is any provision of the Federal Farm Loan Act which would take such Joint Stock Land Bank indebtedness out of the exception clause if, in fact, it is comprehended within it. The plaintiff did, however, urge below, and resubmits here, that such indebtedness of a Joint Stock Land Bank does not fall within either the intended scope or the true literal meaning of the exact language of the exception clause and that such conclusion is confirmed by consideration of the purpose of the exception clause (which was to discourage a practice of tax avoidance) and also by consideration of the purpose of the Federal Farm Loan Act. Plaintiff resubmits that these considerations manifest a clear Congressional intent, which is not only consistent with the language used in the exception clause and corroborative of the plaintiff's construction thereof but is also properly to be heeded in construing the exception clause.

Referring further to the opinion below, the Court of Claims (R. 26-29) recites the purpose of Joint Stock Land Banks, elaborates on the benefits conferred on them to indicate that Congress expected them to be profitable

institutions, and concludes that the granting of certain privileges and benefits to them is not a reason to give them further benefits under the exception clause. This is obviously true and the plaintiff seeks no such concession. By the same token, the plaintiff, calling attention to the counterbalancing restrictions placed on the earning powers of Joint Stock Land Banks and pointing out that all these benefits, privileges and restrictions of the Federal Farm Loan Act were adopted solely because they were essential features of the farm loan scheme and not as primary tax legislation, urges that the interpretation of the scope of any provision of the Income Tax Law should not be colored by the consequences of any tax provision contained in the Federal Farm Loan Act,—unless, of course, the Congress manifests in the Income Tax Law an intent to such effect.

These restrictions in the Federal Farm Loan Act on the earning power of Joint Stock Land Banks were essential to the farm loan scheme,—as was the complete tax exemption contained in Sec. 26 of the Act. In order to get the money to the farmer at a low interest rate Congress expressly in the Farm Loan Act exempted from income tax the interest received on the farmers' first mortgages,—the United States absorbing the income tax loss. It also exempted the interest received by individual purchasers or holders of Joint Stock Land Bank bonds, in order to make these bonds salable,—the United States again absorbing the income tax loss. These things were done primarily not to benefit the Joint Stock Land banks or to penalize existing agencies which had theretofore loaned money to farmers, but primarily and in fact solely because the purpose of Congress was to get money to the farmer at a low interest rate and on reasonable terms, and the scheme definitely required such concessions. Any benefits or detriments to others were

incidental to the main Congressional purpose. Again, obviously to clinch its main purpose and not leave the farmer subject to any potential cupidity on the part of the Joint Stock Land Banks, a limit of six per cent interest was placed on the farmers' first mortgages. There were two additional stipulations for the farmer's benefit, viz.: that the rate of interest charged the farmers should be limited to a figure not in excess of one per cent above the rate of interest on the Joint Stock Land Bank's last issue of bonds and that the Joint Stock Land Bank could not charge any commissions whatsoever. These drastic restrictions on the earning power of Joint Stock Land Banks were, it was thought, counterbalanced by the permission to issue bonds for fifteen times the capital of the bank, which ratio was deemed safe considering the collateral behind the bonds. By this last apparently generous provision and others hereinafter mentioned the Congress indicated its desire that the operations of Joint Stock Land Banks should be profitable. Whether the provisions set up by Congress did or did not, in fact, sufficiently provide for the relatively profitable employment of funds invested in the capital of Joint Stock Land Banks or whether Joint Stock Land Banks, "when properly managed and operated in the manner contemplated in the farm loan act can not be otherwise than highly profitable" (R. 28), is, it is submitted, immaterial in respect of the intent of Congress when it passed the law.

Viewed in the light of the Federal Farm Loan Act, therefore, there is nothing to justify an imputation that the Congress affirmatively conceived or desired additional restrictions on Joint Stock Land Banks or their earning power over and above those expressly fixed in the Federal Farm Loan Act. If anything, the intent of Congress would be to the contrary inasmuch as any

lessening of the net earning power (within the restricted limitations) of its own creatures (Joint Stock Land Banks) would, however remotely, militate *pro tanto* against the success of the land bank system and would, however remotely, defeat *pro tanto* the prospect of the farmers' receiving lower interest rates. The denial of the interest deduction, if it would lessen to any extent the net earning power of any Joint Stock Land Bank, would, therefore, not find support from any intent of Congress manifested in the Federal Farm Loan Act and, at least, such denial cannot be predicated on any intent, express or latent, manifested in the Federal Farm Loan Act.

We now come to a consideration of the fact that the interest on the farmers' first mortgages comprises the major income of a Joint Stock Land Bank and, inasmuch as this interest is exempt under Sec. 26 of the Federal Farm Loan Act, Joint Stock Land Banks, as stated by the Court of Claims (R. 19) "do not ordinarily have income subject to taxation", and a consideration of the bearing of this fact on the interpretation of the interest deduction exception clause.

The Court of Claims, in its original opinion, (without expressing any opinion on the true literal meaning of the exception clause, to which the arguments of the plaintiff and the defendant were directed) concluded that the denial of such interest deduction would adversely affect Joint Stock Land Banks and, considering this in connection with other reasons, held that the Congress did not intend that the exception clause should apply to such indebtedness of Joint Stock Land Banks. The defendant, thereupon, in the rehearing proceedings, directed the court's attention to the fact that *in the particular case* the two subsidiary Joint Stock Land Banks had no independent net taxable income in 1922, aside from

any deduction of interest paid on their bonds, and pointed out that the deduction, if allowed, would redound solely to the benefit of the plaintiff as the parent company. The Court of Claims, granting the rehearing and reversing its judgment, held (again, it is submitted, without due regard to the letter of the statutory language and the Congressional intent) that such indebtedness of a Joint Stock Land Bank falls within the letter of the exception clause and such interest on the bonds was, therefore, not deductible. It is not apparent that the Court of Claims made these considerations the *ratio decidendi* of its opinion. In any event it did not expressly indicate the application of these considerations to the questions at issue. The Court, however, at the threshold of its opinion, conceding that the plaintiff would be entitled to the deduction in its consolidated return "if the Joint Stock Land Banks with which it was affiliated would have had a right to the deduction had they filed independent returns" (R. 19), emphasizes that the question arises solely because of the affiliation (true in the particular case) and that the deduction "in no way affects the Joint Stock Land Banks included in said consolidated return" (true, strictly income-tax-wise, in the particular and possibly also in the ordinary case) and, further, that "Joint Stock Land Banks have no taxable income and they pay no taxes".

As to this latter statement, in a broad sense it is true that Joint Stock Land Banks are not permitted "to engage in any business except that of *making loans to farmers and issuing their bonds* to secure the necessary funds therefor" (R. 19). On the other hand, the interest on farmers' mortgages, although a major source, is not the sole source of income of Joint Stock Land Banks. Other sources of taxable income (excluding items of

lesser importance such as loan fees and penalties on delinquent loans) are interest on bank deposits, profit on real estate, premiums on bonds sold and profit on outstanding bonds purchased at a discount. By Section 16 and Sections 13 Fourth (a) (b) and 13 Fifth of the Federal Farm Loan Act (39 Stat. 372), Joint Stock Land Banks are given the general powers of acquiring and disposing of such property, real or personal, as may be necessary or convenient to the transaction of their business, *which, however, may be in part leased to others for revenue purposes;* of acquiring parcels of land in satisfaction of debts or under foreclosure decrees and *of holding such land five years;* and of depositing securities and current funds with member banks of the Federal Reserve System and *to receive interest on the same as may be agreed.* These sources, including the sale of land acquired in foreclosure, are potentially productive of an appreciable income,—the taxable "net" of which would be increased *pro tanto* by the denial of the deduction of interest paid on Joint Stock Land Banks' bonds. Incidentally, it is conceivable that the operations of some Joint Stock Land Banks, in view of the present disturbed conditions under which they now operate (to be sure, not those immediately contemplated by Congress), might produce an appreciable independent net taxable income,—the interest deduction being denied.

In regard to the benefit of the deduction accruing to the plaintiff under its consolidated return, obviously the Income Tax Law provisions in respect of consolidated returns are a separate and distinct feature of the Income Tax Law adopted for a specific purpose. In the first place, as we shall see later (*infra*, p. 92), the Congress realized that such provisions might result in the collection in one case of higher taxes and in another case

of lower taxes. In the second place, the consequences of the consolidation of income of such affiliated companies under the consolidated return provisions, whether favorable to the Government and unfavorable to the taxpayer in the particular case, (or vice versa, they work both ways), have no pertinent or material bearing on the proper construction of other provisions of the Income Tax Law, such as the interest deduction question at issue, on which the net profit or loss of each company is initially determined. Obviously, Income Tax Law provisions must be construed independently of the consolidated return provisions and their interpretation should not be distorted by a consideration of the consequences of any such interpretation in view of consolidated returns. Any other course, it is submitted, would lead to chaos in respect of the interpretation of the respective provisions of the Income Tax Law. *In other words, the interest deduction clause should be construed in this case as though the Joint Stock Land Banks were independent companies and not involved in a consolidated return.* The Court of Claims agreed that the plaintiff would be entitled to the deduction in its consolidated return "if the Joint Stock Land Banks with which it was affiliated would have had the right to the deduction had they filed independent returns" (R. 19).

We come logically to an inquiry regarding what evidence of Congressional intent (in respect of the meaning of the interest deduction exception clause) can be found in the fact that Joint Stock Land Banks (filing independent returns, respectively) would ordinarily have no net taxable income,—irrespective of the interest deduction. Parenthetically, the fact that such Joint Stock Land Banks (filing independent returns, respectively) would *never* have any net net taxable income (irrespective of the interest deduction) obviously cannot have

any logical bearing on the Congressional intent in respect of the language of the interest deduction exception clause or the scope thereof, inasmuch as any hypothesis that the Congress did consider this fact in selecting the language and fixing the scope of the exception clause (with an intent to include the farmers' first mortgages so as to defeat a deduction of interest on such indebtedness of Joint Stock Land Banks, respectively) requires the inference that Congress added a futile provision, designed to bear on a situation which never would arise and to which it never could have any application. To return to the inquiry, and approaching the Congressional intent on the assumption that the Congress conceived that a Joint Stock Land Bank or some Joint Stock Land Banks, although not ordinarily, *might* have independent net taxable income (irrespective of the interest deduction), we find less justification for any interpretation of the interest deduction exception clause which would extend it by implication so as to include such indebtedness of Joint Stock Land Banks with the resultant denial of ordinary business interest deduction. In fact, considering that such indebtedness of a Joint Stock Land Bank is incurred to carry out the very purpose Congress specified in the Federal Farm Loan Act and was not incurred in any thought of tax avoidance, all implications would tend away from an enlargement of the scope of the clause by implication and toward, if not a restrictive interpretation, at least the true literal interpretation in the light of the precise language used and purpose of the clause,—free from any hypothetical inferences. The Court of Claims, in its first opinion (even without any reference to the precise language of the exception clause) held:

> "It is obvious that the purpose of Congress was to forestall a scheme devised by a taxpayer to re-

duce his taxes. But we cannot believe that Congress intended that the provisions of that statute should apply to the transactions involved in the operation of a Joint Stock Land Bank."

It is apparent, therefore, plaintiff submits, that the fact that a Joint Stock Land Bank ordinarily does not have (or even never may have) any independent net taxable income is immaterial in respect of the interpretation of the interest deduction exception clause and that a true focus brings us ultimately to a consideration of the fact that a parent company might, and in the particular case would, enjoy the benefit of the interest deduction if allowed. This incidental benefit accruing under the independent consolidated return provisions to a parent company, plaintiff repeats (*supra*, p. 86), can have no logical bearing on the interpretation of the interest deduction exception clause,—in the absence of a manifestation of Congressional intent in such respect.

So far as the writer has been able to discover from Committee hearings, Committee Reports and legislative debates in respect of the Federal Farm Loan Act and the interest deduction and consolidated return provisions of the Income Tax Law, there is no direct evidence that Congress was influenced by the fact that such interest deductions might redound to the benefit of a parent company. Of course, if Congress failed to consider this fact, it must follow (however much such failure might be deplored) that such fact had no bearing in the Congressional mind on the meaning of the interest deduction exception clause, the language thereof or the intent of Congress in respect thereof. If the defendant now urges that this fact has any bearing on the interpretation of the exception clause, it should indicate, it is submitted, wherein it is manifested or reflected in any Congressional act or in the language of the exception clause.

Incidentally, such would seem to be consistent not only with the rule of interpretation laid down in *Gould* v. *Gould* (*supra*, p. 79), but also with the rule laid down in *Ryan* v. *Carter* (93 U. S. 78, at p. 83), to the effect that:

> "The general rule of law is, that a proviso carves special exceptions only out of the body of the act, and those who set up any such exception must establish it as being within the *words* as well as the *reason* thereof."

Plaintiff submits that, failing direct evidence that the Congressional mind was influenced by this incidental benefit to a parent company under the independent consolidated return provisions, the interest deduction exception clause should, apart from any such consideration, be construed on the precise language thereof interpreted in the light of its purpose and the purpose of the Federal Farm Loan Act,—which would reflect the immediate and primary intent of Congress.

If the interpretation, thus arrived at, is to the effect that such indebtedness of a Joint Stock Land Bank is not "incurred or continued to purchase or carry obligations or securities the interest upon which is wholly exempt from taxation under this title", the fact that the parent company might in a particular case or in the majority of cases (or in any possible case, if the Court please) be the only one to benefit by the deduction, would not require rejection of such interpretation. In other words, this incidental benefit to a parent company under the consolidated return provisions is not so inconsistent with the Congressional intent manifested in respect of consolidated returns and interest deduction that it would control the interpretation of the interest deduction exception clause.

The plaintiff, submitting that it devolves on the de-

fendant to show such inconsistency (if any), urges that, on the contrary, such incidental benefit to a parent company is quite consistent with Congressional intent as disclosed in the Federal Farm Loan Act and the Income Tax Law.

In the first place, it is not unreasonable to assume that the Congress was aware that the interest on the farmers' first mortgages was a main source of Joint Stock Land Bank income and that such income was exempt under Sec. 26 of the Federal Farm Loan Act. Likewise that Congress was aware that institutions engaged in the farm loan business would not be able to carry on their operations in competition with the Joint Stock Land Banks and that it was not unlikely that banks or companies engaged, either directly or indirectly through subsidiaries, in the making of farm loans would convert these departments or subsidiaries into Joint Stock Land Banks. This, off the record, is what happened with the farm loan department of the plaintiff's subsidiary and, incidentally, was consistent with a suggestion of the Federal Farm Loan Bureau, which desired to have experienced farm loan bankers engage in Joint Stock Land Bank operations,—backed by the strong support of large and experienced financial institutions.

In the second place, the incidental benefit to a parent company is and was quite consistent with the purpose of consolidated returns. The Congress adopted the consolidated return in 1917, has followed it since, and in confirming that policy in connection with the Internal Revenue Bill of 1928 (Senate Committee on Finance, Senate Report No 960, 70th Congress, 1st Session), states the purpose in the following language (italics ours throughout):

> "The situation was described accurately and succinctly by Senator Simmons, at that time the Chair-

man of the Finance Committee and now its ranking minority member, in his report upon the 1918 revenue bill as follows:

> 'Provision has been made in section 240 for a consolidated return, in the case of affiliated corporations, for purposes both of income and profits taxes. A year's trial of the consolidated return under the existing law demonstrated the advisability of conferring upon the commissioner *explicit authority to require such returns.*
>
> So far as its immediate effect is concerned, *consolidation increases the tax in some cases and reduces it in other cases, but its general and permanent effect is to prevent evasion, which can not be successfully blocked in any other way.* * * *
>
> Moreover, a law which contains no requirement for consolidation puts an almost irresistible premium on a segregation or a separate incorporation of activities which would normally be carried as branches of one concern. Increasing evidence has come to light demonstrating that the possibilities of evading taxation in these and allied ways are becoming familiar to the taxpayers of the country. While the committee is convinced that the consolidated return tends to conserve, not to reduce, the revenue, *the committee recommends its adoption not primarily because it operates to prevent evasion of taxes or because of its effect upon the revenue, but because the principle of taxing as a business unit what in reality is a business unit is sound and equitable and convenient both to the taxpayer and to the Government.'* ''

Finally, one more evidence of Congressional intent,—in Sec. 26 of the Federal Farm Loan Act the Congress conferred on every "Federal land bank and every national farm loan association" a tax-exempt status (income-tax-wise), which tax-exempt status was carried into the 1916 Income Tax Law (the year of the adoption of the Federal Farm Loan Act) under Sec. 11 (a) Thir-

teenth, which gave such Federal Land Banks and National Farm Loan Associations the status of tax-exempt corporations. *The Congress, however, did not, either in the Federal Farm Loan Act or the Income Tax Law of* 1916, *confer such tax-exempt status on Joint Stock Land Banks.* Sec. 26 of the Federal Farm Loan Act has remained unchanged and the Income Tax Laws of 1917 (Sec. 11 (a) Thirteenth), of 1918 (Sec. 231, (13)), and of 1921 (Sec. 231 (13)) retain the tax-exempt status in respect of "Federal land banks and national farm loan associations, as provided in Sec. 26 of" the Federal Farm Loan Act. *The Joint Stock Land Banks remain, as before, without any such exemption.* The Act of March 4, 1923 (42 Stat. 1459), which by way of amendment and enlargement of the scope of the Federal Farm Loan Act created the Federal Intermediate Credit Banks, conferred on these banks the tax-exempt status enjoyed by the Federal Land Banks and National Farm Loan Associations under Sec. 26 of the Federal Farm Loan Act. This tax exemption was immediately reflected in the 1924 Income Tax Law (Sec. 231 (13)), which conferred "on *Federal land banks, national farm loan associations, and Federal intermediate credit banks, as provided in the Federal farm loan act, as amended*", the status of tax-exempt corporations. This exemption is carried into the subsequent Income Tax Laws of 1926 and 1928. *The Joint Stock Land Banks have, as from the beginning, remained taxable corporations.*

This deliberate refusal to confer on Joint Stock Land Banks the status of tax-exempt corporations has, or at least is not inconsistent with, two clear inferences. First, the Congress contemplated that Joint Stock Land Banks might (or, at least, that *some of them* would) have net taxable income, and secondly, that Congress in-

tended that Joint Stock Land Banks should remain subject to the full incidences of the Income Tax Laws, including the consolidated return provisions, and that such Income Tax Laws should be applied to such Joint Stock Land Banks as they would be applied to other corporations, without favor or penalty,—the income tax provisions in the Federal Farm Loan Act being considered as special provisions adopted as essential to the particular purpose contemplated in the Federal Farm Loan Act. *On such considerations, undoubtedly, the Bureau of Internal Revenue predicated its holding* (*supra*, p 61) *that "the income of joint-stock land banks is subject to Federal income tax"*. In the last analysis, the fact remains that Congress deliberately left Joint Stock Land Banks subject to the Federal Income Tax Laws and did not exclude Joint Stock Land Banks from the operation of the consolidated return provisions or make any special rule that a minus net income of a Joint Stock Land Bank should be treated differently (in computing a consolidated net income reported by a parent company) from the minus net income of any other affiliated company.

In conclusion, plaintiff submits that the true literal meaning of the interest deduction exception clause should be sought in its precise language interpreted in the light of its purpose and, insofar as the the indebtedness of a Joint Stock Land Bank incurred to make farm mortgage loans is concerned, in the light of the purpose of the Federal Farm Loan Act and independently of any consideration of the benefit of the deduction accruing to a parent company; secondly, that the fact that a Joint Stock Land Bank may not or does not have any net taxable income and that the benefit of the deduction of interest on its bonds might or does accrue to a parent com-

pany under the consolidated return provisions of the Income Tax Laws has no logical bearing on the interpretation of the interest deduction exception clause; thirdly, that if implications are to be indulged in they should be based on some manifestation of Congressional intent and that Congress has not manifested any intent that this interest deduction should be denied because it might redound to the benefit of a parent company, or any intent which is inconsistent with the allowance of this interest deduction in the light of the interest deduction section of the Income Tax Law; and, finally, that the interest deduction exception clause should not be extended "by implication beyond the clear import of the language used" or enlarged "so as to embrace matters not specifically pointed out".

E.

IRRESPECTIVE OF THE INTENDED SCOPE OR LETTER OF THE INTEREST DEDUCTION EXCEPTION CLAUSE, ITS APPLICATION TO SUCH INDEBTEDNESS OF JOINT STOCK LAND BANKS MAY BE SERIOUSLY QUESTIONED IN VIEW OF A RECENT DECISION IN RESPECT OF THE CONSTITUTIONALITY OF THE EXCEPTON CLAUSE AND RULES OF CONSTRUCTION LAID DOWN BY THIS COURT.

Plaintiff, disclaiming any intention of making this point its major contention, submits, without elaboration of argument and more or less collaterally, the following considerations.

In the case of *Nauts* v. *Slayton,* 36 Fed. (2d) 145, (decided December 6, 1929, by the Circuit Court of Appeals, Sixth Circuit, and now pending before this Court on a Writ of Certiorari), it was held that the interest deduction exception clause, to the extent that it was applied to deny a deduction of interest on money borrowed to purchase or carry municipal bonds, was unconstitutional inasmuch as it in effect imposes a tax on municipal obligations,—such taxation not being within the power of Congress. In reaching this decision the Court relied on the case of *National Life Insurance Co.* v. *United States* (277 U. S. 508).

There is, of course, no constitutional limitation on the power of Congress, if it so desired, to deny deduction of interest on indebtedness incurred by a Joint Stock Land Bank to raise funds to loan to farmers under the Federal Farm Loan system. Let us assume for the sake of this argument that, as urged by the defendant, the exception clause contains such a denial. If the interest deduction exception clause is unconstitutional to the extent of its application to the denial of interest on money borrowed to purchase municipal bonds, the plaintiff submits that,

on the principles of construction laid down in *National Life Insurance Co.* v. *United States* (*supra*), at pp. 521-522, the interest deduction exception clause should not be applied so as to result in a denial of the deduction of interest on such indebtedness of a Joint Stock Land Bank, inasmuch as such application to such indebtedness would in effect impose an income tax upon the interest received on the farmers' first mortgages and would, therefore, be contrary to the manifest general purpose of Sec. 26 of the Federal Farm Loan Act which "expressly disavows any purpose to tax interest upon" the farmers' first mortgages and disavows any intention "to subject" such farmers' first mortgages "to burdens which could not be imposed upon those of a State" or municipality.

CONCLUSION.

In conclusion, plaintiff submits that the indebtedness of a Joint Stock Land Bank on its Joint Stock Land Bank Bonds, the proceeds of which are used to make loans to farmers on the security of qualified first mortgages (each loan being made in consideration of the making and delivery by the respective farmer of his mortgage note secured by his farm mortgage), as contemplated and defined in the Federal Farm Loan Act, does not fall within the interest deduction exception clause of Sec. 234 (a) (2) of the Revenue Act of 1921 as "indebtedness incurred or continued to purchase or carry obligations or securities the interest upon which is wholly exempt from taxation under this title" and that, therefore, the interest on such bonds is deductible by said Joint Stock Land Bank under Sec. 234 (a) (2) of the Income Tax Law of 1921.

Plaintiff submits that its interpretation is cumulatively confirmed by the following considerations:

(1) the general deductibility of interest on indebtedness (*supra*, p. 14) and the purpose of Congress in adopting the interest deduction exception clause (*supra*, p. 14);

(2) the actual language of the exception clause in the light of (a) the Congressional purpose in adopting the clause (*supra*, p. 14), (b) the type of indebtedness under consideration (*supra*, p. 16), and (c) its relation to the language of the interest exemption section (*supra*, p. 24),—all in view of the situation "as it was pressed upon the attention of the legislative body" (*supra*, p. 26) and the interpretations heretofore adopted by the Bureau of Internal Revenue in respect thereof.

(3) the purpose of Congress in creating the Federal Farm Loan System and its relation to the spirit and intended scope of the interest deduction exception clause (*supra* p. 28);

(4) the purpose of such Joint Stock Land Bank borrowings (*supra* p. 35) and the use of the proceeds thereof (*supra*, p. 38), as confirmed in the Federal Farm Loan Act, and their bearing on the question whether a Joint Stock Land Bank in borrowing to loan to a farmer on his mortgage note secured by his farm mortgage (incidentally acquired in the transaction) borrows "to purchase or carry" anything whatsoever;

(5) the meaning of the phrase "to purchase or carry", as used in the interest deduction exception clause, in view of (a) the transaction aimed at in the interest deduction exception clause (*supra* p. 19), (b) the ordinary meaning of the words, and (c) the meaning attributed to them by Congress in the contemporaneous language of the Federal Farm Loan Act (*supra* p. 21);

(6) the scope in the interest deduction exception clause of "obligations or securities the interest upon which is wholly exempt from taxation under this title" in the light of Congressional intent as evidenced in the purpose of the interest deduction exception clause and in its relation to the exemption section and the language thereof (*supra* p. 23);

(7) the scope of the exemption section phrase "securities issued under the provisions of the Federal Farm Loan Act" (as to whether it includes farmers' first mortgages) in the light of contemporaneous language of Congress (*supra* p. 53), the legislative history of the phrase "securities issued under the provisions of the Federal Farm Loan Act" (*supra* p. 55), the non-exemption in fact of interest on farmers' first mortgages under the Income Tax Law of 1921 (*supra* p. 58), the rulings of the Internal Revenue Bureau (*supra* p. 61) and the significance of the word "issued" in view of the uniform use of the word "issue" in the Federal Farm Loan Act as definitive of farm loan bonds (as distinguished from the uniform use of the words "qualified", "taken", etc. as definitive of farmers' first mortgages) (*supra* p. 62);

(8) the defendant's alternative interpretation (that the farmers' first mortgages, because of the

exemption contained in Sec. 26 of the Federal Farm Loan Act, are "obligations or securities the interest upon which is wholly exempt from taxation under this title") in the light of interrelation of the phraseology in the exception clause and the exemption section of the Income Tax Law (*supra* p. 72), the consequence of treating the phrase "obligations or securities the interest upon which is wholly exempt from taxation under this title" as independent unrelated words without descriptive force as a unit (*supra* p. 74) and the necessary violence to the language of "exempt from taxation under this title" in view of the history of the phrase as disclosed in the Income Tax Laws (*supra* p. 76) and the significance of the precise language used as distinguished from the suggested equivalent "tax imposed by" (*supra* p. 77); and

(9) the rules of interpretation of statutes levying taxes as laid down by this Court (*supra* p. 79).

Reverting to the statement of questions involved (*supra* pp. 7-8), plaintiff submits that the above considerations clearly bespeak a negative answer not only to the preliminary inquiry (whether such indebtedness of a Joint Stock Land Bank is within the *spirit and intended scope* of the exception clause) but also to each of the three questions set forth in respect of the literal interpretation of the exception clause,—incidentally, a negative answer to the first of these questions determining the issue at the threshold.

Plaintiff further submits that its interpretation of the interest deduction exception clause gives full and direct effect both to the language of the exception clause and the purpose of Congress in adopting it and, moreover, is consistent with and harmonizes every intent of Congress evidenced or manifested in the Federal Farm Loan Act and in the Income Tax Laws, to wit, in the interest deduction exception clause, the interest exemption sec-

tion, the consolidated return provisions and the provisions in respect of tax-exempt corporations.

Plaintiff further submits that its interpretation is plain and direct,—notwithstanding the fact that the presentation and disclosing thereof has required much verbiage in view of the numerous statutes, propositions and related matters involved, including the discussion of the opinion of the Court of Claims.

Plaintiff further submits that the interpretations urged by the defendant are not plain and direct and that they are not reconcilable with the Congressional purpose, the Congressional language (and intent in respect thereof) and interpretations of the interest deduction exception clause heretofore adopted, and accepted by the Internal Revenue Bureau.

The constitutional considerations and the consequences thereof, based on the case of *Nauts* v. *Slayton*, plaintiff submits to the Court, collaterally and without extended argument, solely in the thought that they may be given such effect as the Court may deem necessary or pertinent herein,—in the light of its ultimate decision in the case of *Nauts* v. *Sldyton*.

Respectfully submitted,

HAROLD V. AMBERG,
Attorney for Plaintiff.

III.

APPENDIX.

For ready reference the pertinent parts of the "exemption" and "deduction" sections of the Income Tax Laws of 1913, 1916, 1917, 1918 and 1921 are reprinted in this appendix. Italics are ours.

ACT OF 1913.

Being Section II of the Act of October 3, 1913, entitled "An act to reduce tariff duties and to provide revenue for the Government and for other purposes".

B. That, *subject only to such exemptions and deductions as are hereinafter allowed,* * * * Interest exemption.

That in computing *net income* under this section there shall be excluded

the interest upon the obligations of a State or any political subdivision thereof, and upon the obligations of the United States or its possessions:

* * * * *

G. (a) That the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed, and paid annually upon the entire *net income* arising or accruing from all sources during the preceding calendar year to every corporation, joint stock company or association * * * Deductions.

(b) Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint-stock company or association * * *

(*first*) all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a Ordinary business expense.

condition to the continued use or possession of property;

(*second*) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any;

* * * * * *

(*third*) *the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding one-half of the sum of its interest bearing indebtedness and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of its indebtedness not exceeding the amount of capital employed in the business at the close of the year:*

Provided, That in case of indebtedness wholly secured by collateral the subject of sale in the ordinary business of such corporation, joint stock company, or association, the total interest secured and paid by such company, corporation, or association within the year on any such indebtedness may be deducted as a part of its expense of doing business:

* * * * * *

(*fourth*) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the Government of any foreign country:

* * * * * *

(c) The tax herein imposed shall be computed upon its entire *net income* * * *.

ACT OF 1916.

Being Title I of the Act of September 8, 1916, cited as the "Revenue Act of 1916". (39 Stat. L. 756-77, C. 463.)

Part I.—On Individuals.

Income Defined.

SEC. 2. (a) (1) That *subject only to such exemptions and deductions as are hereinafter allowed* * * * Interest exemption.

SEC. 4. *The following income shall be exempt from the provisions of this title:*

* * * * * *

(4) interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States or its possessions or securities issued under the provisions of the Federal farm loan Act of July seventeenth, nineteen hundred and sixteen:

* * * * * *

Part II.—On Corporations.

Deductions.

SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such *net income* shall be ascertained by deducting from the gross amount of its income received within the year from all sources— Deductions.

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity; Ordinary business expense.

Second. (1) All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including

Second. (2) a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade: * * *

Third. The amount of interest paid within the year on its indebtedness to an amount of such indebtedness not in excess of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding:

Provided, further, That in the case of indebtedness wholly secured by property collateral, tangible or intangible, the subject of sale or hypothecation in the ordinary business of such corporation, joint-stock company or association as a dealer only in the property constituting such collateral, or in loaning the funds thereby procured, the total interest paid by such corporation, company or association within the year on any such indebtedness may be deducted as a part of its expenses of doing business, but interest on such indebtedness shall only be deductible on an amount of such indebtedness not in excess of the actual value of such property collateral: * * *

Fourth. Taxes paid within the year * * *.

ACT OF 1917.

Being Title I of the Revenue Act of 1916 as amended by Title XII of the Act of October 3, 1917, cited as the "Revenue Act of 1917". (40 Stat. L. 300-38, C. 63.)

Part I.—On Individuals.

Income Defined.

Interest exemption.

SEC. 1200. (1) That subdivision (a) of section two of such Act of September eighth, nineteen hundred and sixteen, is hereby amended to read as follows:

"(a) That, *subject only to such exemptions and deductions as are hereinafter allowed,* * * *"

SEC. 1200. (2) Section four of such Act of September eighth, nineteen hundred and sixteen, is hereby amended to read as follows:

"SEC. 4. The following income shall be exempt from the provisions of this title:

* * * * * *

(4) *interest upon the obligations of a State or any political subdivision thereof or upon the obligations of the United States (but in the case of obligations of the United States issued after September first, nineteen hundred and seventeen, only if and to the extent provided in the Act authorizing the issue thereof) or its possessions or securities issued under the provisions of the Federal Farm Loan Act of July seventeenth, nineteen hundred and sixteen:*"

Part II.—On Corporations.

Deductions.

Deductions.

SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

Ordinary business expense.

First. All the ordinary and necessary expenses paid within the year in the maintenance and oper-

ation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity:

Second. (1) All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including * * *

Second. (2) a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;

SEC. 1207. (1) (1) That paragraphs third and fourth of subdivision (a) of section twelve of such act of September eighth, nineteen hundred and sixteen, are hereby amended to read as follows:

SEC. 12. (a) "*Third. The amount of interest paid within the year on its indebtedness (except on indebtedness incurred for the purchase of obligations or securities the interest upon which is exempt from taxation as income under this title) to an amount of such indebtedness not in excess of the sum of (a) the entire amount of the paid-up capital stock outstanding at the close of the year, or, if no capital stock, the entire amount of capital employed in the business at the close of the year, and (b) one-half of its interest-bearing indebtedness then outstanding:*

* * * * *

Provided further, that in the case of indebtedness wholly secured by property collateral, tangible or intangible, the subject of sale or hypothecation in the ordinary business of such corporation, joint-stock company or association as a dealer only in the property constituting such collateral, or in loaning the funds thereby procured, the total interest paid by such corporation, company, or association within the year on any such indebtedness may be deducted as a part of its expenses of doing business, but interest on such indebtedness shall only be deductible on an amount of such indebtedness not in excess of the actual value of such property collateral: * * *

SEC. 12. (a) "*Fourth.* Taxes paid within the year

* * *."

ACT OF 1918.

Being Title II of the Act of February 24, 1919, cited as the "Revenue Act of 1918". (40 Stat. L. 1057-96, C. 18.)

Part II.

Gross Income Defined.

Interest exemption.

SEC. 213. For the purposes of this title (except as otherwise provided in Section 233) the term "gross income" * * * (b) Does not include the following items, which shall be exempt from taxation under this title: (4) *Interest upon (a) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) securities issued under the provisions of the Federal Farm Loan Act of July* 17, 1916; *or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation:* * * * *In the case of obligations of the United States issued after September* 1, 1917, *and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt from taxation to the taxpayer both under this title and under Title III.*

Part III. On Corporations.

Deductions.

Deductions.

SEC. 234 (a) That in computing the net income of a corporation subject to the tax imposed by Section 230 there shall be allowed as deductions:

dinary business expense.

SEC. 234 (a) (1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

terest.

SEC. 234 (a) (2) *All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917) the interest upon which is wholly exempt from taxation under this title as income to the taxpayer, or, in the case of a foreign corporation, the proportion of such interest which the amount of its gross income from sources within the United States bears to the amount of its gross income from all sources within and without the United States:*

xes.

SEC. 234 (a) (3) Taxes paid or accrued within the taxable year * * *

sses.

SEC. 234 (a) (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

d debts.

SEC. 234 (a) (5) Debts ascertained to be worthless and charged off within the taxable year:

ACT OF 1921.

Being Title II of the Act of November 23, 1921, cited as the "Revenue Act of 1921". (42 Stat. L. 227, C. 136).

Part II.

Gross Income Defined.

Interest exemption.

SEC. 213 That for the purposes of this title (except as otherwise provided in section 233) the term "gross income", (b) Does not include the following items, which shall be exempt from taxation under this title: (4) *Interest upon (a) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916; or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income, war profits and excess profits taxes.*

Part III. On Corporations.

Deductions Allowed Corporations.

Deductions.

SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by Section 230 there shall be allowed as deductions:

Ordinary business expense.

SEC. 234. (a) (1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

Interest.

SEC. 234. (a) (2) *All interest paid or accrued within the taxable year on its indebtedness except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.*

Taxes.

SEC. 234. (a) (3) Taxes paid or accrued within the taxable year except * * *

Losses.

SEC. 234. (a) (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise * * *

Bad debts.

SEC. 234. (a) (5) Debts ascertained to be worthless and charged off within the taxable year (or in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); * * *

CHARTER
OF
JOINT STOCK LAND BANK
No. 33.

TREASURY DEPARTMENT
OFFICE OF THE FEDERAL FARM LOAN BOARD

WASHINGTON, D. C., February 24, 1922.

WHEREAS, by satisfactory evidence presented to the Federal Farm Loan Board, it has been made to appear that the First-Trust Joint Stock Land Bank of Chicago, of the City of Chicago, County of Cook, and State of Illinois, has complied with all the provisions of "The Federal Farm Loan act", required to be complied with before such bank shall be granted a charter;

NOW, THEREFORE, the Federal Farm Loan Board does hereby grant a charter to the First-Trust Joint Stock Land Bank of Chicago, of the City of Chicago, County of Cook, and State of Illinois, and said bank is hereby granted authority and power to loan money, issue its bonds, and to do all other things provided for, and in accordance with the provisions of the Act of Congress approved July 17, 1916, known as "The Federal Farm Loan Act", and to do all other things implied or incident thereto within the State of Illinois and the contiguous State of Iowa.

IN WITNESS WHEREOF, the Federal Farm Loan Board has caused this charter to be signed by its executive officer, the Farm Loan Commissioner, attested by its Secretary, and has caused its seal to be hereunto affixed this Twenty-fourth day of February, 1922.

FEDERAL FARM LOAN BOARD
By CHAS. E. LOBDELL
Farm Loan Commissioner.

Attest:
C. R. HEFLIN
(SEAL) *Assistant Secretary.*

FILED
MAY 26 1930
CHARLES ELMORE CROPLEY
CLERK

FILE COPY

No. 905 124

In the Supreme Court of the United States

OCTOBER TERM, 1929

THE FIRST NATIONAL BANK OF CHICAGO, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES

In the Supreme Court of the United States

OCTOBER TERM, 1929

No. 905

THE FIRST NATIONAL BANK OF CHICAGO, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES

The United States does not oppose the petition.

The petitioner during 1922 was affiliated with two Joint Stock Land Banks organized under the Federal Farm Loan Act. (R. 13.) In computing its income in its consolidated tax return for 1922, it deducted the interest paid by the Joint Stock Land Banks on their outstanding bonds. (R. 13.) As contemplated by the Federal Farm Loan Act the banks issued and sold their bonds to secure funds with which they made loans to farmers, the loans being represented by notes secured by approved farm mortgages, the mortgage notes in turn being used as collateral security for additional issues of bonds. The Commissioner disallowed the deduction and assessed an additional tax for the recovery of which this suit was brought. (R. 14.) The Court of Claims dismissed the petition.

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STATUTES INVOLVED

Section 213 of the Revenue Act of 1921, c. 136, 42 Stat. 227, 237, provides in part:

> SEC. 213. That for the purposes of this title * * * the term "gross income"—
>
> * * * * * *
>
> (b) Does not include the following items, which shall be exempt from taxation under this title;
>
> * * * * * *
>
> (4) Interest upon * * * (b) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916.

Section 234 of the Revenue Act of 1921, c. 136, 42 Stat. 227, 254, provides in part:

> SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by Section 230 there shall be allowed as deductions:
>
> * * * * * *
>
> (2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities * * * the interest upon which is wholly exempt from taxation under this title;
>
> * * * * * *

The Federal Farm Loan Act of July 17, 1916, is in chapter 245, 39 Stat. 360. (U. S. C., Title 12, Sec. 641.)

DISCUSSION

The Court of Claims held that the interest paid by the Joint Stock Land Banks to their bondholders

was, under the terms of Sec. 234 (a) (2) of the Revenue Act of 1921, upon "indebtedness incurred * * * to purchase or carry obligations or securities, the interest on which is wholly exempt from taxation under this title," and consequently was not deductible from petitioner's income.

The petitioner contends that the purpose of the interest exception clause, above set forth, was to discourage the borrowing of money by taxpayers for the purpose of purchasing a particular class of tax-exempt securities, and that it was not intended to apply to the operations of Joint Stock Land Banks created under the Farm Loan Act. Specifically the petitioner contends that the indebtedness evidenced by the Joint Stock Land Bank bonds was not incurred for the purpose of purchasing or carrying the farmers' mortgage notes within the meaning of Section 234 (a) (2).

Petitioner further contends that the farmers' mortgage notes are not "obligations or securities, the interest upon which is wholly exempt from taxation under this title" because they are not securities within the phrase "securities issued under the provisions of the Federal Farm Loan Act" of Section 213 (b) (4) (b). It is the contention of the petitioner that the last quoted phrase refers only to the bonds issued by the Joint Stock Land Banks and does not extend to the farmers' mortgage notes acquired by the banks with the proceeds from the sale of the bonds.

There are no decisions in conflict or accord with the opinion below. The questions raised are of general importance and have not yet been decided by this Court. The applicable provisions of the revenue Act of 1921 have been continued unchanged in the later Acts, so that the problems presented by this case are constantly arising under all the more recent Revenue Acts, and there are many unsettled claims presenting the question involved in this case. Several of these claims are pending in other Federal courts.

Although we contend that the decision below was correct, we submit that the question should be determined by this Court.

Respectfully submitted.

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MAY, 1930.

U. S. GOVERNMENT PRINTING OFFICE: 1930

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No. 124

In the Supreme Court of the United States

OCTOBER TERM, 1930

THE FIRST NATIONAL BANK OF CHICAGO, A NATIONAL BANKING ASSOCIATION, PETITIONER

v.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

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BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 17–31) is reported in 69 C. Cls. 312, and in 38 F. (2d) 925.

JURISDICTION

The judgment of the Court of Claims was entered on March 3, 1930. (R. 31.) The petition for certiorari was filed on May 16, 1930 (R. 32), and the writ was granted June 2, 1930 (R. 33), 281 U. S. 719. The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

When a joint-stock land bank is affiliated with a corporation engaged in a general banking business and a consolidated income-tax return is filed for both, does Section 234 (a) (2) of the Revenue Act of 1921 permit a deduction from the gross income of the affiliated group, of interest paid or accrued during the taxable year on farm-loan bonds issued by the joint-stock land bank to acquire funds to loan on farmers' first mortgages?

STATUTES INVOLVED

The statutes involved are set forth in Appendix A, *infra* pp. 28–30.

STATEMENT

The petitioner is a national banking association, having its principal place of business at Chicago, Illinois. (R. 13.) On or about March 14, 1923, the petitioner filed a tentative consolidated income and profits-tax return for the year 1922 for itself and five affiliated corporations, including two joint-stock land banks. On or about June 13, 1923, the petitioner filed a completed return for the affiliated group, showing a net income of $3,482,004.88. (R. 13.)

In computing the net income of the group, the petitioner deducted the amount of $78,807.80 as being interest paid during the year 1922 on farm-loan bonds of the two joint-stock land banks with which it was affiliated. The Commissioner of Internal Revenue disallowed all of this deduction except $5,810.25, representing certain intercom-

pany transactions, which petitioner concedes is not deductible provided the balance is determined to be deductible. (R. 13, 14.)

On or about November 25, 1927, the petitioner filed a claim for refund in the amount of $9,124.70 based upon the disallowance of the deduction for interest paid or accrued on farm-loan bonds. This claim was rejected by the Commissioner on February 14, 1928. (R. 14, 15.)

The two joint-stock land banks with which the petitioner is affiliated were organized under the Federal Farm Loan Act of July 17, 1916, c. 245, 39 Stat. 360. The interest paid or accrued on their farm-loan bonds for the year 1922, which is claimed as a deduction, amounted to $72,997.55. (R. 14, 15.)

The proceeds of the farm-loan bonds were used to make additional loans to farmers on the security of first mortgage notes in accordance with the provisions of the Federal Farm Loan Act. (R. 15, 16.) The interest received by the joint-stock land banks on such notes was not taxed as income to the petitioner for the year 1922.

SUMMARY OF ARGUMENT

The language of Section 234 (a) (2) of the Revenue Act of 1921 is clear and unambiguous and should therefore be interpreted without reference to legislative history or other extrinsic facts designed to qualify the intent expressed in the statute. Under the express provisions of the section a taxpayer may not deduct from gross income interest on "indebtedness incurred or continued to purchase or carry obligations or securities * * * the

interest upon which is wholly exempt from taxation under" the Income Tax title.

The indebtedness represented by farm-loan bonds issued by joint-stock land banks is incurred or continued for the purpose of purchasing or carrying farmers' first-mortgage notes. The interest on such notes is exempt from income tax and is therefore "exempt from taxation under" the Income Tax title, regardless of the source from which the exemption is derived. Moreover, it is specifically exempted by Section 213 (b) (4) (b) as "interest upon * * * securities issued under the provisions of the Federal Farm Loan Act."

If the deduction of interest paid on farm-loan bonds be denied to joint-stock land banks, no legislative policy is violated. The purpose of the interest deduction exception clause is to prevent taxpayers from deriving a double benefit from holding tax-exempt securities. Because Congress has extended certain favors to joint-stock land banks, it does not follow that the Revenue Act must be so construed as to grant them a further immunity.

Since the taxable income of a joint-stock land bank is relatively small, denial of this deduction does not constitute a substantial burden. Moreover, where, as here, the land bank is affiliated with a general banking corporation the burden is almost exclusively on the affiliated corporation rather than on the land bank, so that the benefit to the land bank, if the deduction were permitted, would be negligible.

ARGUMENT

I

PRELIMINARY STATEMENT

Joint-stock land banks are authorized by Section 16 of the Federal Farm Loan Act of July 17, 1916, c. 245, 39 Stat. 360, 374 (U. S. C., Title 12, Sec. 811–821), to issue farm-loan bonds for the purpose of acquiring funds which may be loaned to farmers on the security of first-mortgage notes. The interest paid by the farmers on their mortgage notes is exempt from taxation as income to the joint-stock land banks. We submit that such banks are not entitled to a further deduction from their gross income on account of the interest paid by them on their farm-loan bonds. Such bonds are within the scope of Section 234 (a) (2) of the Revenue Act of 1921 (*infra*, pp. 28–29), denying deduction of interest on—

> indebtedness incurred or continued to purchase or carry obligations or securities * * * the interest upon which is wholly exempt from taxation under this title.

The petitioner contends that farm-loan bonds are not within the spirit or the express terms of the above clause, and endeavors to show that the language of the clause must be construed in the light of certain general legislative policies. The Government, on the other hand, takes the position that the meaning of the clause is clear and unambiguous, that its effect should not be limited by considera-

tions of supposed legislative intent, and that denial of the deduction in question would not be violative of any policies which Congress has established.

The burden of establishing an exemption from taxation is on the taxpayer. *Botany Worsted Mills* v. *United States*, 278 U. S. 282, 289, 290; *Franciscus Realty Co.* v. *Commissioner*, 39 F. (2d) 583 (C. C. A. 8th). Here the taxpayer is attempting to show that a statute expressly refusing exemption of interest paid on money borrowed to purchase or carry tax-exempt securities should be so construed as not to include this taxpayer while including others similarly situated. We submit that the petitioner has not succeeded in establishing its right to the deduction claimed, and the greater part of this brief will necessarily be devoted to a consideration of the arguments advanced by the taxpayer for the purpose of defeating the plain meaning of the statute.

II

THE INDEBTEDNESS REPRESENTED BY THE FARM-LOAN BONDS ISSUED BY PETITIONER'S SUBSIDIARY JOINT-STOCK LAND BANKS WAS INCURRED OR CONTINUED "TO PURCHASE OR CARRY" FARMERS' FIRST-MORTGAGE NOTES

In its analysis of the language of Section 234 (a) (2) of the Revenue Act of 1921 (*infra*, pp. 28–29), the petitioner first contends that the indebtedness of a joint-stock land bank represented by bonds which are issued to create a fund for making loans to

farmers on the security of first-mortgage notes is not "indebtedness incurred or continued to purchase or carry" such mortgage notes.

While conceding, for the sake of argument, that in order to come within the interest deduction exception clause, the indebtedness must be incurred or continued for the express purpose of purchasing or carrying exempt securities, we submit that such purpose is clearly indicated in the instant case. The Court of Claims found that the proceeds of the farm loan bonds issued by the petitioner's subsidiaries were used to make loans to farmers "which new loans * * * were made in each instance in consideration of the making and delivery by the borrowing farmers, respectively, of their promissory notes secured as to payment by first mortgages on their farms." (R. 15, Finding 6.) The court concluded in its opinion (R. 22) that the acquisition of such notes with these funds was a purchase of securities within the meaning of the Revenue Act.

In contending that this conclusion was erroneous, the petitioner disregards the dual nature of the transaction and construes various isolated phrases in the Farm Loan Act as establishing finally and for all purposes the character of the dealings between the farmer and the bank. But the relationship must be viewed comprehensively. While undoubtedly a loan is made to the farmer, that is but one phase of the transaction. Joint-stock land

banks are supported by private capital and are intended to operate at a profit. From the bank's viewpoint, therefore, its indebtedness is incurred for the purpose of enabling it to acquire interest-bearing obligations secured by first mortgages on approved farm lands. The bank hopes in this manner to secure for its stockholders a return on their investment, without which it would not be able to function. The acquisition of such obligations would seem to be a purchase within the meaning of the Revenue Act.

The provisions of the Federal Farm Loan Act were designed merely to establish and regulate the procedure whereby farmers might secure long-term loans at reasonable rates of interest. They do not purport to stamp the transaction as a loan for all purposes nor to declare arbitrarily that it may not under any circumstances be regarded as a purchase of securities.

We submit that the word "purchase" as used in the Revenue Act has no special or technical significance but should be interpreted as meaning just what it is normally understood to mean, without regard to the language of other statutes having no relation to the general field of taxation. Generally "purchase" connotes the idea of acquisition for a valuable consideration, usually monetary. As applied to the instant case this definition is clearly sufficient to bring the acquisition of first-mortgage notes by joint-stock land banks within the scope of the interest deduction exception clause.

Moreover, if the meaning of "purchase" be restricted, as petitioner urges, to the acquisition of securities which are already outstanding, and be held not to include acquisition at the time of inception, the result is to read into Section 234 (a) (2) an implied exception with respect to all tax-exempt obligations or securities as to which the taxpayer is the original obligee. We submit that such an interpretation of the Act would be entirely unjustified. The specific exclusion from the exception clause of Section 234 (a) (2) of certain Federal securities originally subscribed for by the taxpayer indicates that Congress considered that such original subscription would be a purchase and that interest on indebtedness incurred for the purpose of acquiring such securities at the time of their inception would be taxable were it not for the proviso.

While we believe that the indebtedness represented by the bonds of the joint-stock land bank is incurred for the purpose of purchasing tax-exempt securities within the meaning of Section 234 (a) (2), we submit that such indebtedness may also be incurred in some cases to carry such securities. Although the word "carry" is normally used to describe the operation of purchasing on credit where interest is paid to the vendor, it may also have a broader significance such as was assigned to it by the Court of Claims. (R. 22.) Clearly the joint-stock land bank does not pay interest on farmers' notes, but it does incur certain overhead ex-

penses in connection with its operations, and to that extent its indebtedness may be said to be incurred for the purpose of carrying these notes. See General Counsel's Memorandum 2000, VI–2 Cumulative Bulletin, p. 248.

III

FARMERS' FIRST MORTGAGE NOTES ARE "OBLIGATIONS OR SECURITIES * * * INTEREST UPON WHICH IS WHOLLY EXEMPT FROM TAXATION UNDER THIS TITLE"

The petitioner contends that the exception set forth in Section 234 (a) (2) of the Revenue Act of 1921 as to "indebtedness incurred or continued to purchase or carry obligations or securities * * * the interest upon which is wholly exempt from taxation under this title" must be construed to refer only to obligations or securities which are specifically exempted by Section 213 (b) (*infra*, p. 28) and that when so construed it does not include farm loan bonds for the reason that the first-mortgage notes taken as security for loans made out of the proceeds of such bonds are not "securities issued under the provisions of the Federal Farm Loan Act."

We contend that the language of Section 234 (a) (2) refers to obligations or securities the interest on which is immune from income taxation regardless of the source from which the immunity is derived. We contend further that if the petitioner is correct in stating that the exception includes only such obligations or securities as are specifically

exempted by Section 213 (b), nevertheless farmers' first-mortgage notes are "securities issued under the provisions of the Federal Farm Loan Act" and are therefore within the scope of both the exemption provisions and the interest-deduction exception clause.

A. *The exception clause of Section 234 (a) (2) refers to obligations or securities the interest upon which is exempt from income tax, regardless of the source from which such exemption is derived.*

We submit that there is no justification or necessity for looking beyond the language of the Revenue Act in order to determine the meaning of the interest-deduction exception clause. That clause prohibits the deduction of interest on all indebtedness incurred or continued in connection with the acquisition of obligations or securities "the interest upon which is wholly exempt from taxation under this title." It is obvious that the title referred to is Title II, which includes all provisions relating to income tax.

The petitioner insists that the exception should be read as though the words "from taxation" had been omitted. This is in direct conflict with the settled principle of statutory interpretation requiring that all words used by the legislature are to be given effect and meaning. *United States* v. *Standard Brewery, Inc.*, 251 U. S. 210, 218. Article 180 of Regulations 33, promulgated under the Revenue

Act of 1916, as amended by the Revenue Act of 1917, adopts the interpretation which we believe to be correct. It states that interest paid on indebtedness may be deducted from gross income—

> provided it does not include interest on indebtedness incurred in the purchase of securities, the income from which is not subject to income tax.

Grammatically, the words "under this title" should be read as a limitation upon the word "taxation," the last antecedent, rather than upon "exempt," a more remote antecedent, unless some good reason to the contrary is shown. 2 *Lewis' Sutherland, Statutory Construction* (2d ed.), p. 811. When so read the clause is entirely free from ambiguity and must be given effect according to its express terms. Its natural, obvious meaning should not be altered by judicial construction based upon a supposed general intent of the Legislature. *Bate Refrigerating Company* v. *Sulzberger*, 157 U. S. 1; *United States* v. *Lexington Mill Company*, 232 U. S. 399.

Precisely the same expression appears in Section 213 (b) in a context which renders even more unlikely the meaning which the petitioner suggests. That section provides in part as follows:

> That for the purpose of this title * * * the term "gross income" * * * (b) does not include the following items, which shall be exempt from taxation under this title * * *.

As in Section 234, the title referred to is "Title II—Income Tax." It would not be reasonable to construe the phrase "under this title" in Section 213 as limiting the word "exempt" rather than the word "taxation" inasmuch as "taxation under this title" is the burden from which the items listed in the section are exempted. It seems clear that "taxation under this title" is the equivalent of "income tax" and that the meaning of Section 213 (b) would have been exactly the same if Congress had stated that the specified items should be "exempt from income tax." Since precisely the same words are used in Section 234 (a) (2), they should receive the same interpretation.

If our interpretation of Section 234 (a) (2) is correct, interest on farm loan bonds is not deductible from gross income, since, as the petitioner concedes, farmers' first mortgage notes are exempt from the tax imposed by Title II of the Revenue Act.

B. *If the exception clause in Section 234 (a) (2) be construed as referring only to obligations or securities interest upon which is specifically exempted by Section 213 (b) (4), farmers' first-mortgage notes are still within the scope of the exception, inasmuch as they are "securities issued under the provisions of the Federal Farm Loan Act"*

In support of its contention that the interest deduction exception clause in Section 234 (a) (2)

of the Revenue Act of 1921 should be construed as referring only to obligations or securities the interest upon which is in terms exempted by Section 213 (b) (4), the petitioner relies principally upon the language of Section 26 of the Federal Farm Loan Act, c. 245, 39 Stat. 360, 380 (U. S. C., Title 12, Sec. 931–933), *infra*, pp. 29–30, in which farm-loan bonds are spoken of as being "issued under the provisions of this Act," whereas first mortgages are referred to as being "executed to Federal land banks or to joint-stock land banks." We submit that the language appearing in the Federal Farm Loan Act has no bearing on the interpretation of Section 234 (a) (2). It was intended merely to describe the instruments which should be immune from taxation, and there is no reason whatever to suppose that Congress desired to deny to first-mortgage notes the character of being "issued under the provisions of" the Farm Loan Act. The choice of language was purely fortuitous in so far as it relates to the present issue.

Further support for the petitioner's contention is sought to be derived from the history of Section 213 (b) (4) (b), which, as the petitioner has shown on pages 55 and 56 of its brief, originated in Section 4 of the Revenue Act of 1916, c. 463, 39 Stat. 756, 758. It is said that Section 4 can not have been intended to include farmers' first-mortgage notes for the reason that it applied only to exemptions to

individuals, whereas such notes are exempt only when issued or executed to corporations, i. e., Federal land banks or joint-stock land banks.

We answer that the petitioner's premise is erroneous. Section 4 of the 1916 Act appears under the income tax title, which includes all provisions relating to income tax on corporations as well as those dealing with the tax on the income of individuals. It reads in part as follows:

> The following income shall be exempt from the provisions of this title:
> * * * The obligations of the United States or its possessions or securities issued under the provisions of the Federal farm loan Act of July 17, 1916 * * *.

It will be observed that the specified items contributing to gross income are exempted by this section from the provisions of "this title," which must be construed as meaning the whole title, including that part relating to corporations. Regulations 33, issued under the Act of 1916, contain a series of articles under the heading "Income-Tax Regulations Relating to Corporations." Articles 83 to 87 under this heading deal with "Income Exempt From Tax" and show clearly that Section 4 was construed as being applicable to corporations as well as to individuals. Although the exemption in favor of securities issued under the provisions of the Farm Loan Act is not mentioned, Article 85 relates to obligations of the United States, which

are classified as exempt under the same exception. Therefore under the 1916 Act corporations were entitled to exclude, in the computation of their gross income, the exempted items specified in Section 4.

Consequently, there is no basis for the contention that Section 4 could not have been intended to include farmers' first-mortgage notes. Moreover, the premise on which the contention is founded would lead to the conclusion that interest on farm-loan bonds is not exempted by Section 4 where such bonds are held by corporations other than those protected by Section 11 (a) Fourteenth. Yet the petitioner concedes that farm-loan bonds are "securities issued under the provisions of the Federal farm loan Act" and the supposed distinction between these bonds and first-mortgage notes is not supported by the facts.

The ruling of the Income Tax Unit in I. T. 2470, VIII–1 Cumulative Bulletin, p. 69, part of which is quoted in the petitioner's brief (p. 62), does not support the contention that farmers' notes are rendered exempt solely by virtue of Section 26 of the Farm Loan Act. The ruling was made with reference to the Revenue Act of 1928, c. 852, 45 Stat. 791, 798, section 22 (b) (4) of which is substantially identical with Section 213 (b) (4) (b) of the Act of 1921. The concluding sentence of this ruling, which does not appear in the petitioner's brief, reads as follows:

> The income derived from the mortgages executed to the Federal land banks should, therefore, be excluded from gross income under the provisions of section 22 (b) (4) of the Revenue Act of 1928 and article 85 of Regulations 74.

It thus appears that the Income Tax Unit in deciding that farmers' first-mortgage notes are exempt, considered both the Revenue Act and the Farm Loan Act—the former as the primary authority for the exemption and the latter to determine what obligations or securities within the purview of the Farm Loan Act, Congress intended to relieve from the burden of taxation.

This interpretation of the ruling is supported by an earlier ruling cited on page 61 of the petitioner's brief to the effect that notes executed by joint-stock land banks are not entitled to a tax-exempt status. I. T. 1806, II-2 Cumulative Bulletin, p. 92. There is nothing to indicate that Congress intended to confer a tax-exempt status on such notes as "securities issued under the provisions of the Federal farm loan Act" since they were not exempted by the provisions of the Farm Loan Act itself. The two rulings of the Income Tax Unit merely limit the scope of Section 213 (b) (4) (b) to those instruments designated by Congress in Section 26 of the Farm Loan Act as being in the nature of instrumentalities of the Federal Government. Farmers' first-mortgage notes fall within this class.

We submit that there is no merit to the contention that first-mortgage notes are not "issued under the provisions of the Federal farm loan Act," when it is evident that they are essential to the operation of the farm loan plan, are the final security upon which the integrity of the bonds depends, and are in fact the very basis of the system created by the Act. While it is true that they do not, in the last analysis, depend for their validity on the provisions of the Farm Loan Act, nevertheless their value as integral parts of the farm loan scheme does depend entirely on their conforming to the requirements specified in the Act. Furthermore, their immunity from taxation is derived in the first place from the Farm Loan Act and is contingent upon their being in sufficient conformity with the requirements of the Act to be acceptable to land banks.

Finally, in reply to the contention that Congress contemplated that the obligations or securities referred to in Section 234 (a) (2) and Section 213 (b) (4) should include only securities of a type similar to those specified in clauses (a), (c), and (d) of Section 213 (b) (4) (obligations of the States and political subdivisions thereof or of the United States and its possessions or of the War Finance Corporation), it seems sufficient to observe (1) that the existence of such an intention is purely conjectural, and (2) that by Section 26 of the Farm Loan Act Congress expressly conferred upon farm-

ers' first-mortgage notes a degree of dignity comparable for tax purposes to that enjoyed by obligations of the Federal Government.

IV

CONSIDERATIONS OF LEGISLATIVE INTENT OR POLICY DO NOT REQUIRE THAT SECTION 234 (a) (2) OF THE REVENUE ACT OF 1921 BE INTERPRETED SO AS TO PERMIT THE DEDUCTION FROM GROSS INCOME OF JOINT-STOCK LAND BANKS OF INTEREST PAID OR ACCRUED ON THEIR FARM-LOAN BONDS

As the petitioner has pointed out in its brief, the legislative history of Section 234 (a) (2) of the Revenue Act of 1921 indicates that the exception clause was designed to discourage the practice of buying tax-exempt securities on a large scale with borrowed money and deducting interest paid on such borrowings from taxable income derived from other sources. It is clear that in issuing farm-loan bonds joint-stock land banks are merely performing one of the functions for which they were created and are not attempting to evade tax liability. The petitioner therefore concludes that the interest-deduction exception clause is not applicable to interest paid on farm-loan bonds. With this conclusion we are unable to agree.

It may be observed, in the first place, that there is no justification for petitioner's contention that the interest deduction exception clause should be limited in its application by the provisions of Section 234 (a) (1), permitting the deduction of "ordinary and necessary" business expenses. Interest pay-

ments and business expenses have always been treated as separate and distinct items with respect to deductibility. Act of October 3, 1913, c. 16, 38 Stat. 114, 172, Sec. II, G (b); Revenue Act of 1916, c. 463, 39 Stat. 756, 767, Sec. 12 (a), as amended by Revenue Act of 1917, c. 63, 40 Stat. 300, 334, Sec. 1207 (1); Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077, Sec. 234 (a); Revenue Act of 1921, c. 136, 42 Stat. 227, 254, Sec. 234 (a). See also Regulations 62 (1922 ed.), Article 561. The separation of the two deductible items is as distinct here as it was in Section 38 of the Corporation Tax Act of August 5, 1909, c. 6, 36 Stat. 11, 112, construed by this Court in *Anderson* v. *Forty-two Broadway Company*, 239 U. S. 69. See *Nauts* v. *Slayton*, 36 F. (2d) 145, 146 (C. C. A. 6th), reversed on certiorari by this court February 24, 1931, *sub nom. Denman* v. *Slayton*, No. 60, October Term, 1930.

With respect to the purpose of the exception clause, there is, we submit, a real distinction between the reasons which prompted the enactment and the intent evidenced by the statute as adopted. It is frequently necessary in order that undesirable practices may be checked to legislate in terms sufficiently broad to include activities other than those at which the legislation is primarily directed. Yet if the language of the statute is clear, an unexpressed motive will not supply implied limitations where none are declared. *Caminetti* v. *United States*, 242 U. S. 470. We submit that the provi-

sions of Section 234 (a) (2) are unambiguous and that they should be taken at their face value. See *Denman* v. *Slayton, supra.*

Moreover, the purpose of the exception clause was in fact broader than the petitioner suggests. The unrestricted deductibility of interest on indebtedness gave to the exemption clause an effect substantially greater than that which it was originally intended to have, since it permitted the taxpayer to deduct from taxable income something more than the interest received on tax-exempt securities. When Congress realized that these seemingly unrelated provisions were operating together to reduce taxable income to an extent greater than had been contemplated, it inserted into Section 234 (a) (2) the exception clause now under discussion. The direct effect of the various exemption provisions remained unchanged, but their indirect effect on taxable income through the interest-deduction clause was removed.

There is no reason to believe that Congress intended the exception clause to relate only to indebtedness incurred for the express purpose of evading taxation. The petitioner itself does not contend that the taxpayer's intention is material. Nor does the statute justify a distinction being drawn between one who is engaged primarily in the purchase of exempt securities and the casual investor in such securities. See *Denman* v. *Slayton, supra.*

The situation is not analagous to that presented in *National Life Insurance Co.* v. *United States*, 277 U. S. 508. That case involved Section 245 (a) of the Revenue Act of 1921, which permitted life insurance companies to deduct from gross income interest received upon exempt securities plus a sum equal to 4% of their legal reserve diminished by the amount of such interest. This Court held there was such a direct relation between the deduction allowed for exempt securities and the diminution of the deduction for the legal reserve as to negative the constitutional exemption guaranteed to state and municipal obligations. It held further that Congress did not intend to nullify in such manner the exemption granted by statute to the obligations of the Federal Government.

But there is no direct connection between interest on exempt securities and interest on indebtedness incurred to purchase or carry such securities. The indebtedness may represent only an insignificant fraction of the exempt holdings. In the *National Life Insurance Company case* the effect of the statute was to increase the net income so that the total was the same as if the exempt income were itself taxed. In the instant case, on the other hand, the statute merely prevents the further reduction of the normal taxable basis by the payments made to buy or carry exempt securities. The income from exempt securities remains unchanged.

The instant case bears a marked similarity to *Denman* v. *Slayton, supra,* except that here, as the petitioner concedes (Br. p. 96) "there is, of course, no constitutional limitation on the power of Congress, if it so desired, to deny deduction of interest on" joint-stock land-bank bonds. Inasmuch as this Court has decided that no unconstitutional burden was imposed upon the municipal borrowing power by the tax assessed in the *Slayton case,* it follows that in the instant case there is no burden upon first-mortgage notes and no question as to the intent of Congress to avoid such a burden. Thus the principle of construction laid down in the *National Life Insurance Company case* is not relevant to the instant case. Moreover, it seems clear that an appreciable burden must be shown to exist in fact before a statute will be construed as inapplicable on that ground. See *Willcuts* v. *Bunn,* No. 22, October Term, 1930, decided January 5, 1931.

It is urged by the petitioner that inasmuch as Congress has expressly exempted from income tax the interest received on farmers' first-mortgage notes, Section 234 (a) (2) must be construed as extending the exemption to interest on indebtedness represented by farm-loan bonds. But if Congress had intended to grant a comprehensive exemption to everything connected with the operation of the farm-loan plan, it would have included joint-stock land banks among those corporations

which are entirely free from income tax. Yet, as the petitioner concedes, such banks are subject to taxation on all income received from nonexempt sources.

The income of the joint-stock land bank consists almost entirely of interest on first-mortgage notes. (Petitioner's brief, p. 84.) Such other income as it may receive is derived from the exercise of powers which are merely incidental to its main purpose. Moreover, it is admitted that in the instant case the two subsidiary land banks had no independent net taxable income in 1922, even aside from any deduction of interest paid on their bonds. (Petitioner's brief, pp. 84–85.)

If, therefore, the Revenue Act be so construed as to permit land banks to deduct from their relatively small amount of taxable income the interest paid on their land bonds, it is reasonable to believe that invariably the net result would be to leave them no taxable income whatever. If, on the other hand, the privilege of deducting interest paid on land bonds be denied in accordance, as we contend, with the plain language of the Revenue Act, the exemption of interest on first-mortgage notes would in no way be affected, and the indirect burden on the operation of the farm-loan plan would be negligible. See *Denman* v. *Slayton, supra.*

The provisions of the Federal Farm Loan Act give no indication of an intention on the part of Congress that joint-stock land banks shall receive

any favors other than those specifically set out in the Act. As the Court of Claims said in its opinion (R. 29):

> Construing the language of the exception to the interest-deduction clause in Section 234 (a) (2) to mean what the words used import deprives the plaintiff of no benefit the provisions of the Farm Loan Act accord to it. On the other hand, to give the language used the construction contended for by the plaintiff would give to it a benefit nowhere granted in the Act.

The question is of no considerable importance except in cases like the instant one where the land bank is affiliated with a corporation engaged in a general banking business and a consolidated return is filed for both. Under such circumstances the land bank probably contributes relatively little to the gross income of the group, and in the instant case it is conceded that the subsidiary land banks contributed nothing. (Petitioner's brief, pp. 84–85.) The deduction of interest on its bonds, if allowed, will affect the tax liability of the land bank slightly, if at all. Nevertheless, it is contended that a general legislative policy to relieve the farm-loan plan of certain specified burdens should be invoked as the deciding factor in interpreting the Revenue Act in such a way as to permit a deduction from the taxable income, not of the land bank but of the general banking corporation with which it is affiliated.

We realize, of course, that the consolidated return necessarily operates to the advantage of the taxpayer in some cases and to the advantage of the Government in others. If the Revenue Act clearly permitted the deduction in question, we should have no hesitation in conceding that it should be reflected in the taxable income of the affiliated group. But when the scope of the deduction clause is in dispute and the argument based on a policy of favoring land banks is adduced as a guide to interpretation, we feel free to suggest that the allowance or disallowance of the deduction will have no appreciable effect on land banks, but will react almost exclusively upon general banking corporations which are admittedly outside the protective pale.

In 1923, when the present question was first raised under the 1921 Act, the Treasury Department took the position that Section 234 (a) (2) did not permit the deduction of interest paid on farm-loan bonds (see Appendix B, *infra*, pp. 31–33). In 1927 the General Counsel of the Bureau of Internal Revenue published a memorandum on the identical question here presented and ruled that interest on farm-loan bonds was not deductible. G. C. M. 2000, VI–2 Cumulative Bulletin, p. 248. It is significant that although the practice of the Department in this respect has been uniform since 1923, the exception clause has been reenacted without change in all subsequent Revenue Acts. This would indicate that Congress was not dissatisfied with the manner in

which Section 234 (a) (2) had been construed by the Department.

CONCLUSION

The judgment of the Court of Claims should be affirmed.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.
CHARLES B. RUGG,
Assistant Attorney General.
H. BRIAN HOLLAND,
ERWIN N. GRISWOLD,
BRADLEY B. GILMAN,
Attorneys.

FEBRUARY, 1931.

APPENDIX A

STATUTES INVOLVED

The Revenue Act of 1921, c. 136, 42 Stat. 227, 237, 238, 254, provides in part:

> SEC. 213. That for the purpose of this title (except as otherwise provided in section 233) the term "gross income"—
>
> * * * * *
>
> (b) Does not include the following items, which shall be exempt from taxation under this title:
>
> * * * * *
>
> (4) Interest upon (a) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916; or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation. * * *
>
> * * * * *
>
> SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> (1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *;
>
> (2) All interest paid or accrued within the taxable year on its indebtedness, except

on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

* * * * * *

The Federal Farm Loan Act of July 17, 1916, c. 245, 39 Stat., 360, 380 (U. S. C., Title 12, Secs. 931–933), provides in part:

SEC. 26. That every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation.

Nothing herein shall prevent the shares in any joint stock land bank from being included in the valuation of the personal property of the owner or holder of such shares, in assessing taxes imposed by authority of the State within which the bank is located; but such assessment and taxation shall be in manner and subject to the conditions and limitations contained in section fifty-two

hundred and nineteen of the Revised Statutes with reference to the shares of national banking associations.

Nothing herein shall be construed to exempt the real property of Federal and joint stock land banks and national farm loan associations from either State, county, or municipal taxes, to the same extent, according to its value, as other real property is taxed.

APPENDIX B

JUNE 13, 1923.

CHARLES H. PRESTON AND COMPANY,
Plymouth Building, Minneapolis, Minnesota.

SIRS: Receipt is acknowledged of your letter dated May 23, 1923, in which you make certain inquiries as to the taxable income and deductions of joint stock land banks, which information is desired in order properly to prepare the complete return for 1922 of the Southern Minnesota First Joint Stock and Land Bank, Redwood Falls, Minnesota.

You state that the chief source of the income of joint stock land banks is interest on mortgages and inquire whether such income is taxable. The statement is made that if such income is not taxable under the provisions of Section 26 of the Federal Farm Loan Act it would be an impossibility for a joint stock land bank ever to show a taxable net income and information is requested as to why it is necessary for such bank to file a return.

You refer to income tax ruling IT:1349, in which it is held that dividends on joint stock land-bank stock are subject to surtax and inquire why its dividends should be taxable if the net income received by the bank is nontaxable. You also ask whether interest paid by the bank on its farm loan bonds is allowable as a deduction.

You are advised that under the provisions of Section 26 of the Federal Farm Loan Act the interest received by joint stock land banks (organized

under that Act) on first mortgages executed to such banks is exempt from income tax. Other income received by joint stock land banks is taxable or nontaxable depending upon the character of such income.

Every corporation which is not specifically exempt from tax under the provisions of Section 231 of the Revenue Act of 1921 is required to file a return of its income. Inasmuch as joint stock land banks are not included in the corporations enumerated as exempt from taxation under that section, such banks are required to file returns although such returns may disclose no tax liability.

Dividends paid by joint stock land banks are required to be reported in gross income under the provisions of Section 213 (a) of the Revenue Act of 1921 although the chief income of such banks is interest on first mortgages which is exempt from tax. Dividends of Federal land banks and national farm loan associations are exempt from all Federal income tax under that portion of Section 26 of the Federal Farm Loan Act which reads as follows:

> Every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen of this Act.

There is nothing in this provision of the Federal Farm Loan Act or any other provisions of the Act

which exempts from tax the dividends paid by joint stock land banks.

The interest paid by a joint stock land bank on the farm loan bonds issued by such bank is not an allowable deduction in computing net income inasmuch as such farm loan bonds represent indebtedness incurred by the joint stock land bank to carry obligations (namely, first mortgages executed to the bank) the interest upon which is wholly exempt from income tax.

Respectfully,

E. W. CHATTERTON,
Deputy Commissioner.

By (Sgd.) H. O. ARMSTRONG,
Chief of Section.

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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

No. 124.

THE FIRST NATIONAL BANK OF CHICAGO, *Plaintiff*,

v.

THE UNITED STATES.

On Writ of Certiorari to the Court of Claims of the United States.

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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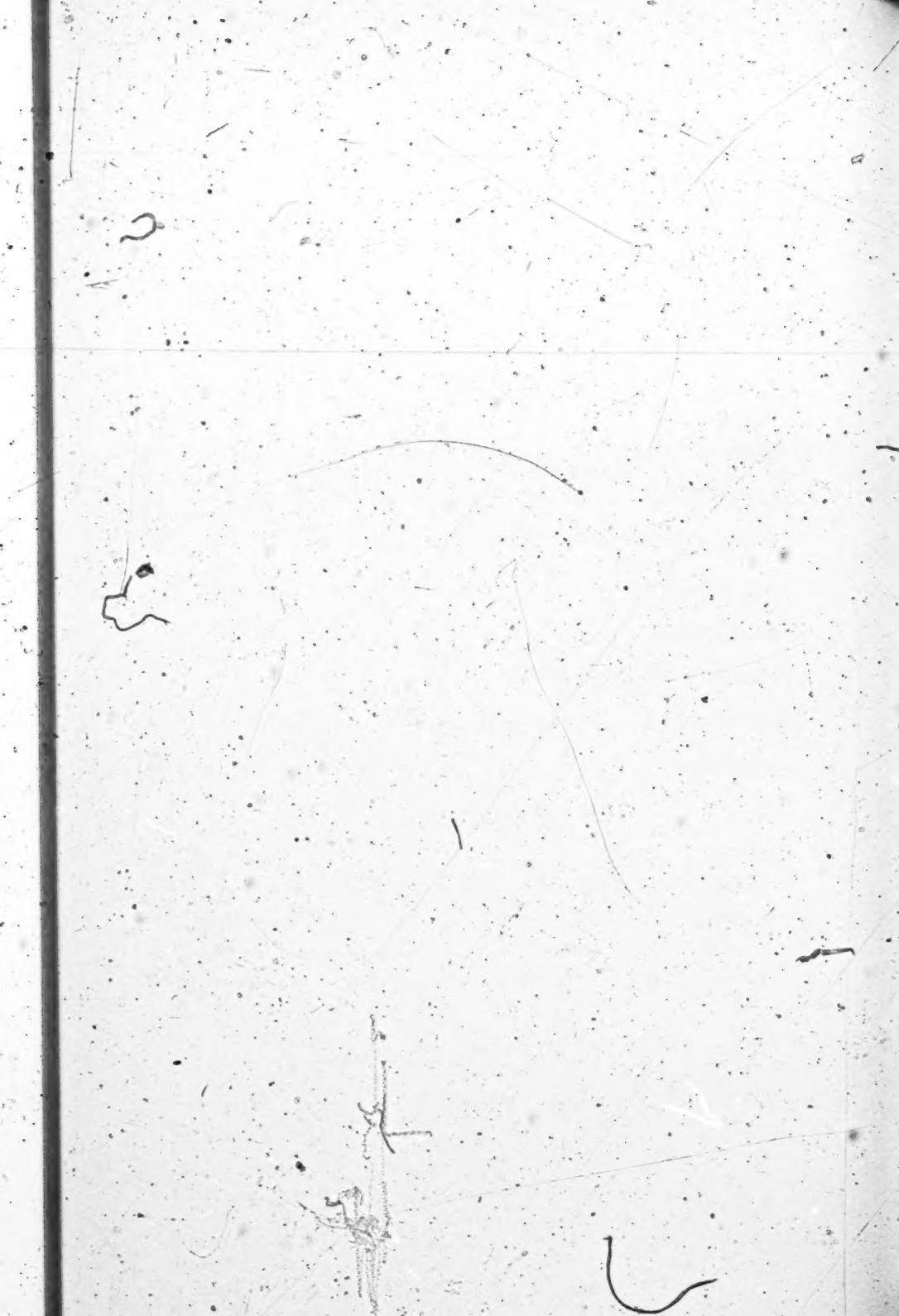

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MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE, AND BRIEF.

May it Please the Court:

The undersigned respectfully moves this Honorable Court for leave to file a brief in this case as amicus curiae.

JOHN E. MCCLURE,
922 Southern Building,
Washington, D. C.,
Attorney for Bank of Commerce & Trust Company.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

No. 124.

THE FIRST NATIONAL BANK OF CHICAGO, *Plaintiff*,

v.

THE UNITED STATES.

BRIEF ON BEHALF OF BANK OF COMMERCE & TRUST COMPANY AS AMICUS CURIAE.

The *Bank of Commerce & Trust Company* of Memphis, Tennessee, has pending before the Income Tax Unit the question relating to the deductibility of interest paid by joint stock land banks on joint stock land bonds, the proceeds of which were used to make mortgage loans to farmers. We have been advised that the determination of our question will be deferred until the decision by the Supreme Court in *First National Bank of Chicago, Plaintiff vs. United States.*

Opinion Below.

The opinion of the Court of Claims is reported in 69 Ct. Cls. 312.

Jurisdiction.

The judgment to be reviewed was entered March 3, 1930, and this case is before this court by virtue of an order entered June 2, 1930, granting plaintiff's petition for a writ of certiorari to the Court of Claims of the United States.

Question Presented.

The single issue is whether or not a joint stock land bank may, in computing its net income under the Revenue Act of 1921, deduct the interest paid on its bonds, the proceeds of such bonds being used to make loans to farmers on farm mortgage securities.

Law Involved.

Section 213, Revenue Act of 1921, provides that the term gross income does not include:

> "(4) Interest upon * * * (b) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916;"

Section 234, Revenue Act of 1921, provides that, in computing the net income of a corporation subject to the tax imposed by Section 230, there shall be allowed as deductions:

> "(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or

carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer), the interest upon which is wholly exempt from taxation under this title;"

Section 26 of the Federal Farm Loan Act (39 Stat. 360, 380) provides in part as follows:

"First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of the Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal and local taxation."

Statement.

A full statement of the facts is set out on pages 2 to 5, inclusive, of the plaintiff's brief which, succinctly stated, shows that during 1922 the joint stock land banks paid interest of $72,997.55 on their bonds, the proceeds of these bonds having been used to make loans to farmers on farm mortgage securities, each loan being made in consideration of the executing and delivering by the respective farmer of a mortgage. The taxing authorities disallowed the interest paid as a deduction from gross income.

Summary of Argument.

In passing the Federal Farm Loan Act it was the intention of Congress to encourage agricultural development and assist farmers to borrow money secured by first mortgages on their farms. To this end Congress specifically provided in Section 26 of the

Federal Farm Loan Act that the income from the first mortgages should be exempt from any and all taxation. The exemption from taxation is contained in the Federal Farm Loan Act itself and not in the Revenue Act of 1921. The Revenue Act of 1921, Section 213 (b)(4)(b), exempts from taxation "securities issued" under the Federal Farm Loan Act, and obviously a "mortgage executed" does not fall within the category of "securities issued". The words "securities issued", as contained in the exemption provision of the 1921 Act, are to be applied as that term is ordinarily used. Furthermore, Congress, in declaring the first mortgages to be instrumentalities of the government of the United States, intended that such mortgages should, for taxation purposes, be treated the same as if they were obligations of the United States.

Argument.

An examination of the brief filed by plaintiff indicates no necessity on our part for a repetition, hence we confine this brief to the following points which we seek to stress:

Congress had a Definite Purpose in Mind in Exempting from Taxation the Income derived from First Mortgages executed under the Federal Farm Loan Act.

The legislative history of the Federal Farm Loan Act (39 Stat. 360) discloses an intention by Congress to encourage agricultural development by enabling farmers to borrow money secured by first mortgages on their farms, and providing that such farmers would

pay only a reasonable rate of interest on such loans. The mortgages and farm loan bonds are the very essence of the Act. *31 Op. Atty. Gen. 103.* When Congress passed the Federal Farm Loan Act it had before it reports from agricultural sections to the effect that farmers had been forced to mortgage their properties most detrimental to them, and had been required to pay high interest rates on the loans. In Section 12 of the Act, there was inserted definite restrictions on loans based on first mortgages.

In order to induce the public to invest capital in the Federal land banks and joint stock land banks Congress inserted in Section 26 of the Farm Loan Act a provision exempting first mortgages from any and all taxation. Congress also inserted other provisions in the Act for the purpose of attracting the public to invest capital in the enterprise. And all such provisions, especially the exemption from taxation provision, was a part of the primary plan of giving aid to the distressed condition of farmers.

The Provision with Respect to Exemption from Taxation of Income from First Mortgages executed to Federal Joint Stock Land Banks is contained in the Federal Farm Loan Act and not under Title II of the Revenue Act of 1921. The Words "Executed" and "Issued" are not Synonyms.

Considerable thought and discussion is involved in ascertaining the source of exemption from taxation of the interest on first mortgages executed under the Federal Farm Loan Act. Clearly the Federal Farm Loan Act itself (39 Stat. 360, 380) specifically provides that the first mortgages and the income derived therefrom shall be exempt from taxation. *32 Op.*

Atty. Gen. 54. But it is argued by defendant's counsel that Section 213 (b) (4), (b) Revenue Act of 1921, also exempts the same interest from taxation. Now in order to be exempt under Section 213 (b) (4), (b) Revenue Act of 1921, it is necessary that the interest must be paid upon "securities *issued* under the provisions of the Federal Farm Loan Act". Accepting the ordinary meaning of words used by Congress, it seems clear that (1) a mortgage is "executed" and not "issued", and (2) Congress used the word "securities" as having reference to "bonds" issued and not "mortgages" executed. These distinctions are what Congress had in mind when they enacted the exemption clause in the Federal Farm Loan Act. Congress said "mortgages *executed*",—not "mortgages issued".

Congress having referred to "mortgages *executed*" and "bonds *issued*" in the Federal Farm Loan Act, it seems desirable to stress the fact that Section 213 (b) (4) (b) uses only one of those terms, viz., securities *issued* under the provisions of the Federal Farm Loan Act.

Therefore, since mortgages are *executed* and not *issued,* Congress did not intend that mortgages were to be classed as "securities".

None of These Mortgages can Ever be said to be issued. A Farmer's Obligation may total a Million Dollars and Yet he Could Truthfully say That he had Never issued an Obligation.

In order to fall within the phrase "exempt from taxation under this title" as contained in Section 234 (a) (2), it is necessary to find that Congress, somewhere under that title (Title II), exempted the in-

terest from taxation. The defendant seeks to show that the interest is exempt from taxation under the phrase "securities issued" as contained in Section 213 (b)(4)(b).

We would respectfully point out that Congress, in using the phrase "securities issued", meant exactly what it said, and intended only for the exception to apply to such obligations as are capable of issuance, namely, notes, bonds, certificates, and other negotiable or transferable instruments. For example—

> "The execution and delivery of an instrument or obligation not intended for further circulation by delivery is rarely spoken of as an issue of such instrument." *Lusk v. Stoughton State Bank,* 133 Wis. 311, 115 N. W. 813.

Therefore, when a farmer executes a mortgage to a joint stock land bank, that act creates an express obligation, but that obligation is not issued. Plainly it has never been "issued".

The word "obligation" used in the same Section has as wide if not a wider meaning than the word "securities". While all securities are obligations it seems fair to say that all obligations are not securities. The Board of Tax Appeals, in construing the word "obligation" as used in Section 213 of the 1918 Act, similar to the 1921 Act, stated as follows:

> "Although the word 'obligation' is broad enough to cover the duty resting upon the Government to pay just compensation, we are of the opinion that its application is more restricted under section 213 (b) (4) of the Revenue Act of 1918. We have examined the Congressional Record so far as practicable with respect to all the

acts containing these exemption clauses, but unfortunately we find no expressions upon the part of the legislators which would aid in determining precisely what should be treated as an obligation under the statute. The apparent purpose for exempting from taxation the interest upon obligations of the United States was to facilitate the flotation of low-interest-bearing Government securities, thus partially compensating for the higher interest rates of competitive private issues. The reason for the exemption does not apply to interest on obligations, construing that word in the broad sense for which the petitioner contends." *Kansas City Southern Railway Company v. Commissioner*, 16 B. T. A. 665, 691.

It is therefore submitted that when Congress used the phrase "securities issued" it used it in its ordinary and accepted meaning, and its ordinary usage would not extend to include a mortgage executed by a farmer for the purpose of borrowing money. And certainly if a written contract between a carrier and the Director General does not fall within the term "obligation" it is difficult to see how a mortgage executed would fall within the phrase "securities issued".

Congress intended that Mortgages executed by the Farmers should, for Taxation Purposes, be treated the Same as if They were Obligations of the United States.

Admittedly the mortgages executed by the farmers under the provisions of the Federal Farm Loan Act, in fact are obligations of the farmers, but it is equally true that, for taxation purposes, such mortgages should be considered and regarded as obligations of

the United States, for Congress declared that they *"shall be deemed and held to be instrumentalities of the Government of the United States"*.

In other words, while the mortgages in question may not *in fact* be instrumentalities of the United States, nevertheless, for taxation purposes, they "shall be deemed and held" to be such. Now the word "deemed" has acquired a very definite meaning. The Court of Appeals for the Second Circuit in *Douglas vs. Edwards*, 298 Fed. 229, 237, through Mr. Justice Mayer, speaking for the Court, stated:

> "We may dispose at the outset of the meaning of 'deemed'. If it had been intended that this word should mean a rebuttable and not a conclusive presumption, the word 'presumed' could readily have been used, and that is a word which is very familiar in many statutes. 'Deemed', and its synonym, 'regarded' according to definitions in cases and dictionaries, is the equivalent of 'considered' or 'adjudged'. *Leonard vs. Grant*, (C. C.) 5 Fed. 11, 16; *United States v. Doherty*, (D. C.) 27 Fed. 730, 734; *Michel vs. Nunn*, (C. C.) 101 Fed. 423; *Cardinel vs. Smith*, 5 Fed. Cas. 45, 47; *Walton vs. Cavin*, 16 Q. B. 48, 81."

In *Leonard vs. Grant*, 5 Fed. 11, 16, the court on construing the phrase "shall be deemed a citizen", stated:

> "The word 'deemed' is the equivalent of 'considered' or 'adjudged'; and, therefore, whatever an act of Congress requires to be 'deemed' or 'taken' as true of any person or thing, must, in law, be considered as having been duly adjudged or established concerning such person or thing, and have force and effect accordingly. When, therefore, Congress declares that an alien woman

shall, under certain circumstances, be 'deemed' an American citizen, the effect, when the contingency occurs, is equivalent to her being naturalized directly by an act of Congress, or in the usual mode thereby prescribed."

Certainly there are no reasons to deny deductions of the interest in question because Congress in passing the Federal Farm Loan Act, was trying to help and not hinder the farmers. To deny the deduction of the interest paid out by the bank would have the effect of taxing the interest received on the mortgages. On reason alone the interest should be allowed as a deduction. Therefore, since these mortgages are to be treated the same as Government obligations, an analysis of the Act will show that the interest is taken out of the exception of Section 234 (a) (2) of Title II, of the Revenue Act of 1921, by the parenthetical clause "(*other than obligations of the United States issued after September 24, 1917*, and originally subscribed for by the taxpayer)".

That is to say, if a taxpayer pays interest on indebtedness incurred or continued to purchase or carry State, county, or municipal securities, the law provides that such interest may not be deducted, but if the same or another taxpayer pays interest on indebtedness incurred or continued to purchase or carry obligations of the United States issued after September 24, 1917, the interest is deductible. Therefore, since Congress has said that the mortgages executed and the bonds issued under the provisions of the Federal Farm Loan Act "shall be *deemed and held to be instrumentalities of the Government* of the United States" for purposes of taxation, whether Federal, State, or otherwise, such mortgages should be treated as if they were mortgages of the United States.

There is no room for any other construction of what Congress said. If they are not to be treated as if they were obligations of the United States, there would be no purpose of Congress in making such mortgages exempt from State, municipal and local taxes. Congress has very wide powers in such matters, and it was within the province of Congress to declare that, for taxation purposes, these mortgages were to be treated as obligations of the United States are treated, thereby placing them beyond the power of the state governments to levy a tax thereon. Congress had this very thought in mind. It devoted an entire paragraph to the exemption of these securities. It was not just a word—the skin of a thought—but the thought itself.

Congress never Intended that the Exception Clause of Section 234 (a) (2), Revenue Act of 1921, was to Apply to Joint Stock Land Banks making Loans to Farmers.

As previously shown, Congress exempted the interest on mortgages from taxation to make the Federal Farm Loan banking business attractive to those with capital to invest. And while the Federal Farm Loan Act clearly exempts the interest of first mortgages from taxation, it is argued by defendant's counsel that since the interest on the mortgages is exempt from taxation the bank may not deduct the interest paid out on its bonds, because of the phrase in Section 234 (a) (2), Act of 1921, reading "the interest upon which is wholly exempt from taxation under this title." In short, defendant's counsel argues that the interest on the first mortgages falls within the phrase "exempt from taxation under this title",

meaning Title II of the Revenue Act of 1921. The only provisions of Title II referring to exemption of interest from taxation is contained in Section 213 (b), which provides that gross income does not include interest upon "*securities issued* under the provisions of the Federal Farm Loan Act of July 17, 1916." That is to say, no matter where the exemption is contained the income is exempt under Title II of the Revenue Act. Argued differently, it is said that if Title II had been completely silent with respect to making interest exempt (thereby leaving the Federal Farm Loan Act as the sole source of exemption) the interest would fall within the phrase "exempt from taxation under this title".

Now, it is right here that we differ with defendant's counsel, for in order that interest be exempt *under* the title means to be exempt with the sanction, authorization or permission of the title. See *32 Op. Atty. Gen. 54.* In Section 231, Revenue Act of 1921, numerous corporations are "exempt from taxation under this title", but a foreign corporation who has no income from sources within the United States is not "exempt under this title" merely because it is not sought to be taxed or specifically made exempt. The foreign corporation not being subject to the income tax law is exempt *from* the title, but not *under* the title.

The Court Below Erroneously assumes that Joint Stock Land Banks do not Ordinarily have Income Subject to Taxation.

In the opinion by Judge Williams, of the Court of Claims, it is stated:

"Joint stock land banks, not being permitted to engage in any business, except that of making loans to farmers and issuing their bonds to procure the necessary funds therefor, do not ordinarily have income subject to taxation, and so long as such banks operate as individual and separate institutions, it cannot make the slightest difference whether they have or do not have the right to deduct the interest paid on their bonds. Their income is tax exempt, and consequently the right to make deductions therefrom means nothing."

We submit that the foregoing assumption is erroneous in that joint stock land banks do in fact have taxable income. It is true that the interest received on the loans to farmers is exempt from taxation, but it is equally true that joint stock land banks have income other than interest received on loans made to farmers. This income may arise out of selling property previously acquired under foreclosure proceedings, or out of other transactions entered into within its scope of business. A joint stock land bank, generally speaking, has the same powers and is subject to the same restrictions and conditions imposed upon the Federal land banks. An examination of Section 4 of the Federal Farm Loan Act does not disclose the restrictions as to business undertakings as stated above in the opinion. In fact, in Section 22, a joint stock land bank is specifically authorized to purchase United States Government bonds, which bonds may be sold at a profit taxable under the Revenue Act, although the interest on such bonds is not taxable. And of course there are numerous other ways in which a joint stock land bank may have income. See I. T. 1806 (II-2 C. B. 92) holding that the

net income of Joint Stock Land Banks is subject to Federal income tax.

It is true that the record in the present case does not disclose taxable income on the part of the joint stock land banks, but, nevertheless, the Mississippi Joint Stock Land Bank and the Tennessee Joint Stock Land Bank do have taxable income.

Conclusion.

The judgment of the Court of Claims should be reversed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

No. 124

THE FIRST NATIONAL BANK OF CHICAGO,
Petitioner,

vs.

UNITED STATES OF AMERICA.

PETITION FOR REHEARING.

HAROLD V. AMBERG,
Counsel for Petitioner.

BLAKELY-WARREN PRINTING COMPANY, CHICAGO.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1930.

No. 124.

THE FIRST NATIONAL BANK OF CHICAGO,
Petitioner,

vs.

UNITED STATES OF AMERICA.

PETITION FOR REHEARING.

Comes now the petitioner in the above entitled cause and respectfully petitions the Court for a rehearing in the above entitled cause on the ground that the decision herein is predicated on a constructive Congressional intent based, as petitioner submits further analysis will show, on a misconception of Congressional intent in respect of consolidated returns and a misconception of facts arising out of inexact off-the-record statements made by the Court of Claims and adopted by the Court.

The petitioner respectfully submits:

I.

Within the scope of unequivocal statutory language, the returns of the two Joint Stock Land Banks were included in the consolidated return of the petitioner and such consolidated return has been consistently accepted by the Commissioner of Internal Revenue and is not at issue herein.

As to Congressional intent,—not only is there no exception in respect of Joint Stock Land Banks in the consolidated return provisions, but, to the contrary, there is distinct evidence that Congress affirmatively intended that Joint Stock Land Banks should be treated like other private corporations under the Income Tax Laws. *Congress in* 1917 *deliberately refrained* (*and has since deliberately refrained*) *from conferring on Joint Stock Land Banks the status of tax-exempt corporations* (the simple way to take them out of the operation of the consolidated return provisions of the Income Tax Laws) at times when it conferred such status on their companions,—the Federal Land Banks and Intermediate Credit Banks. (Petitioner's brief, pp. 92-93.) Congress apparently contemplated that Joint Stock Land Banks would have taxable income and the Bureau of Internal Revenue has held that "the net income of Joint Stock Land Banks is subject to Federal Income Tax" (Petitioner's brief, p. 61) *but, with or without taxable income, Joint Stock Land Banks were left, not inadvertently, within the operation of the Income Tax Laws.*

Furthermore, such a consolidated return is within the recently confirmed Congressional intent, expressed (Petitioner's brief, p. 92) as follows:

> "the committee recommends its adoption not primarily because it operates to prevent evasion of taxes or because of its effect upon the revenue, but because the principle of taxing as a business unit what in reality is a business unit is sound and equitable and convenient both to the taxpayer and to the Government."

Had it been at issue, it could easily have been demonstrated or stipulated that the Joint Stock Land Banks were not only, in fact, integral parts of the petitioner's business unit (incidentally so with the acquiescence and/or encouragement of all Federal agencies con-

cerned) but also, in law, within the degree of affiliation prescribed in the statute. The affiliation was not the result of a preconceived design on the part of the parent company to get relief from taxation,—any consequence thereof, income-tax-wise, being merely a fortuitous result of an affiliation originating from impulses completely divorced from Income Tax considerations (Petitioner's brief, p. 91).

II.

The interpretation of the interest deduction provision should not be influenced by the consequences of the result under the consolidated return provision any more than the clear authorization to file such a consolidated return should be questioned because it might result in a benefit to the parent company under the interest deduction provision. The interpretation of each provision should be independent of the interpretation of the other and such independent interpretations should not be colored subsequently by the consequences of putting the two interpretations together. Although neither inference should be indulged, it is submitted that, if the consequences of putting the two interpretations together is to color either or both interpretations, there is more justification (this being tax legislation) for an inference that the defendant must affirmatively show that Congress intended such coloration than for an inference that the petitioner must show the contrary.

All such considerations aside, the interest deduction exception clause should be construed as though the issue were raised on the independent return of a Joint Stock Land Bank; (Court of Claims, R. 19; Petitioner's brief, pp. 85, 86-87),—*otherwise the Court will, tacitly at least, sanction the theory that the intent of Congress in respect*

of an Income Tax provision is contingent on the consequences under the consolidated return provisions.

III.

The factual off-the-record conclusion of the Court of Claims that the deduction of interest on its bonds makes no difference to an independent Joint Stock Land Bank should not be adopted casually and, even if true, should influence the interpretation of the interest deduction provision only to the extent that it can be shown to have influenced the intent of Congress. Furthermore, passing the fact that this Court should take judicial notice that the statement of the Court of Claims that "Joint Stock Land Banks are not permitted to engage in any business except that of making loans to farmers and issuing bonds" is not true (Petitioner's brief, pp. 85-86) and passing the fact that the Bureau of Internal Revenue has held "the net income of Joint Stock Land Banks is subject to Federal Income Tax" (Petitioner's brief, p. 61), it should not be assumed, off the record, that Joint Stock Land Banks "have no taxable income and they pay no taxes." The record is silent in these respects because both the Government and the petitioner considered both considerations irrelevant. Incidentally, in the brief as *amicus curiae*, filed herein, it is alleged that the Mississippi Joint Stock Land Bank and the Tennessee Joint Stock Land Bank do have taxable income. *So far as the intent and letter of the interest deduction provisions are concerned, the essential factor is that Congress contemplated Joint Stock Land Banks as taxable units,—as has the Bureau of Internal Revenue.*

IV.

As held by this Court in *Denman* v. *Slayton*, decided February 24, 1931, and confirmed herein, the "manifest purpose" of the exception to the interest deduction provision "was to prevent the escape from taxation of income properly subject thereto by the purchase of exempt securities with borrowed money." *Clearly the indebtedness of a Joint Stock Land Bank incurred to create funds to loan to farmers, as contemplated by Congress in the Federal Farm Loan Act, is not within the "manifest purpose" of the exception clause.* Furthermore, the casual coincidence of interest received and deduction of interest paid does not per-force bring it within the exception clause (Petitioner's brief, pp. 16-19).

As to the letter of the interest deduction exception clause, Section 13 of the Farm Loan Act, referred to by the Court, empowering Federal Land Banks to invest their funds "in the *purchase* of qualified first mortgages on farm lands *situated within the Federal Land Bank District,*" is an exact description of Federal Land Bank's operations in that *they do "purchase" notes and mortgages from National Farm Loan Associations,* organized under Sections 7, 8, 9 and 11 of the Act (Petitioner's brief, pp. 46-47). *Joint Stock Land Banks, however, loan directly to farmers* and the word "purchase" in Section 13 (even in view of the language of Section 16 referred to by the Court) is no more applicable to a Joint Stock Land Bank's lending operations than is the reference to "the Federal Land Bank District" or numerous other limitations in the Act applicable solely to Federal Land Banks. Other considerations in respect of "purchase or carry," set forth in petitioner's brief, pp. 38-51, are, it is respectfully submitted, controlling to the contrary.

Again as to the letter of the interest deduction provision, considerations set forth in petitioner's brief, pp. 52-67, are, it is respectfully submitted, controlling to the effect that the farmers' first mortgage notes and mortgages do not fall within Section 213 (b) (4) (b) as "securities *issued* under the provisions of the Federal Farm Loan Act" and such considerations should prevail over any general reasoning that because the farmers' notes and mortgages are designed and acquired in contemplation of the Federal Farm Loan Act they are, therefore, "securities *issued* under the provisions of the Federal Farm Loan Act." *The same general reasoning would justify a conclusion that Liberty bonds are "securities issued under the provisions of the Federal Farm Loan Act"* because they, in common with the farmers' first mortgage notes and mortgages, may be used, interchangeably with farmers' first mortgage notes and mortgages, as collateral security for the issuance of Joint Stock Land Bank bonds.

For the foregoing reasons, it is respectfully urged that this petition for a rehearing be granted and that the judgment of the Court of Claims be, upon further consideration, reversed.

Respectfully submitted,

HAROLD V. AMBERG,
Counsel for Petitioner.

CERTIFICATE OF COUNSEL.

I, Harold V. Amberg, counsel for the above named petitioner, DO HEREBY CERTIFY that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

HAROLD V. AMBERG,
Counsel for Petitioner.

SUPREME COURT OF THE UNITED STATES.

No. 124.—October Term, 1930.

The First National Bank of Chicago, a National Banking Association, Petitioner,
vs.
The United States.

On Writ of Certiorari to the Court of Claims.

[April 13, 1931.]

Mr. Justice McReynolds delivered the opinion of the Court.

The First National Bank of Chicago made a consolidated corporation income and profits tax return for the year 1922 which, among other things, disclosed results from operations of two affiliated corporations, the First Trust Joint Stock Land Banks of Chicago and Dallas, organized under the Federal Farm Loan Act of 1916. It claimed the right to deduct from total receipts the amounts paid (or accrued) during the year by the Land Banks for interest upon their outstanding bonds. The Commissioner refused to allow the deductions. Payment as demanded was followed by suit to recover in the Court of Claims. Judgment went against the Bank and the matter is here upon certiorari.

From the findings, based upon a stipulation of facts, it appears—

> "The First Trust Joint Stock Land Bank of Chicago and the First Trust Joint Stock Bank of Dallas, which were organized under the Federal farm loan act of July 17, 1916, issued to and/or had outstanding in the hands of the public in the year 1922 their joint-stock land bank bonds, respectively, on which interest was paid and/or accrued in the year 1922, in the aggregate sum of $78,807.80, part of which was the intercompany transaction in the amount of $5,810.25, leaving a balance paid or accrued of $72,997.55. As security for the payment of said joint-stock land bank bonds said joint-stock land banks, as provided in the Federal farm loan act, deposited with the proper farm loan registrars

farmers' promissory notes evidencing loans to said farmers, which in turn were secured as to payment by said farmers' first mortgages on their farms.

"The proceeds coming into the hands of said joint-stock land banks from the issuance and sale of said joint-stock land banks bonds were used by said joint-stock land banks to make new additional loans to farmers, which new loans made from the proceeds of said joint-stock land bank bonds issued and/or outstanding in 1922, were made in each instance in consideration of the making and delivery by the borrowing farmers, respectively, of their promissory notes secured as to payment by first mortgages on their farms. All of said loans, respectively, and the farmers' notes and mortgages, respectively, evidencing said loans, were designed to be and were of such a nature as to comply with (1) all the terms, conditions, restrictions, limitations, and requirements specified in the Federal farm loan act, as requisite to qualify said loans, notes, and mortgages, as 'first mortgages' in contemplation of said act, so as to make them available as collateral security against the issue of joint-stock land bank bonds; and (2) all terms, conditions, restrictions, limitations, and requirements, statutory or otherwise, specified in the laws of the State in which the farm which was the subject of the particular loan was located (to wit, the States of Illinois, Iowa, Texas, and Oklahoma, respectively), as requisite to qualify said loans, notes, and mortgages as valid and subsisting first mortgages, in contemplation of such laws. Said notes and mortgages contain an agreement providing for the repayment of the loan on the amortization plan, as provided in section 12, second, of the Federal farm loan act, and such agreement in respect of each note and/or mortgage was not extinguished within a period of less than thirty-three years, except, of course, at the option of the borrower.

"The interest received by the plaintiff on such farmers' notes and mortgages was not taxable as income to the plaintiff and was not so taxed in respect of plaintiff's return for the year 1922."

Decision of the cause must turn upon the construction of pertinent portions, Revenue Act 1921, Title II, c. 136, 42 Stat. 227, 237, 238, 252, 254.

Sec. 213 provides that the term "gross income" does not include interest upon "securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916."

Sec. 230 imposes a tax at specified rates upon the net income of every corporation.

Sec. 234 provides—"(a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions: . . . (2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;"

The Federal Farm Loan Act 1916, c. 245, 39 Stat. 360, 372, 374, 380, provides (Sec. 16) for the formation of joint stock land banks "for carrying on the business of lending on farm mortgage security and issuing farm loan bonds" which "shall have the powers of, and be subject to all the restrictions and conditions imposed on, Federal land banks by this Act, so far as such restrictions and conditions are applicable:". Sec. 13 authorizes Federal land banks: "First. To issue, subject to the approval of the Federal Farm Loan Board, and to sell farm loan bonds of the kinds authorized in this Act, to buy the same for its own account, and to retire the same at or before maturity. Second. To invest such funds as may be in its possession in the purchase of qualified first mortgages on farm lands situated within the Federal land bank district within which it is organized or for which it is acting." Sec. 26. "That every Federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes upon real estate held, purchased, or taken by said bank or association under the provisions of section eleven and section thirteen of this Act. First mortgages executed to Federal land banks, or to joint stock land banks, and farm loan bonds issued under the provisions of this Act, shall be deemed and held to be instrumentalities of the Government of the United States, and as such they and the income derived therefrom shall be exempt from Federal, State, municipal, and local taxation."

As pointed out by the court below—"Joint-stock land banks, not being permitted to engage in any business, except that of making loans to farmers and issuing their bonds to procure the necessary funds therefor, do not ordinarily have income subject to taxation, and so long as such banks operate as individual and separate institutions, it can not make the slightest difference whether they have or do not have the right to deduct the interest paid on their bonds. Their income is tax exempt, and consequently the right to make deductions therefrom means nothing. When, as in the instant case, joint-stock land banks are affiliated with banking corporations that do have taxable incomes, the question assumes importance, as the interest deduction, if allowed, reduces the tax liability of the affiliated group—even then, however, it in no way affects the joint-stock land banks included in such consolidation. They have no taxable income and they pay no taxes."

Considering the circumstances, we find no reason to conclude that Congress intended to permit any ordinary commercial bank, with income subject to taxation, to secure partial relief therefrom through affiliation with a joint-stock land bank. That result would follow approval of the petitioner's position.

In *Denman etc., Nauts, Collector,* v. *Slayton,* decided February 24, 1931, we said—"The manifest purpose of the exception in paragraph 2, Sec. 214 (a), was to prevent the escape from taxation of income properly subject thereto by the purchase of exempt securities with borrowed money."

The Federal Farm Loan Act (Secs. 16 and 13) empowers Joint Stock Land Banks to invest their funds "in the purchase of qualified first mortgages on farm lands." The obvious meaning is that loans might be made on such security. Loans, so made, become "securities issued under the provisions of the" Act and interest upon them is wholly exempt from taxation under Title II, Revenue Act of 1921.

Interpreting the language of the exception in Sec. 234 in view of the legislative purpose, we think that the farm mortgages owned by the affiliated Joint Stock Land Bank must be regarded as "obligations or securities the interest upon which is wholly exempt from taxation under this title," and that the bonds issued by them constituted indebtedness incurred to purchase or carry such obligations.

Affirmed.